Aalto University
School of Business

THE FINNISH SEARCH FUND MODEL

A feasibility study of the Search Fund model for the Finnish market

Master's Thesis
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Abstract

Search fund is an investment vehicle that provides an aspiring entrepreneur with opportunity to search for, acquire, manage, and grow a company. Since 1983, 258 U.S. search funds have returned aggregate ROI 8.4x and IRR 37%. Search funds have been identified in UK, Spain and Germany, but not in the Nordic.

Search fund model can provide advantages for both investors and searchers. Investors are able to invest in young talent and established micro-growth companies, which are typically beyond the reach of the traditional private equity model. Searcher are able to become CEOs of running businesses with significant equity stake early in their careers.

In order to evaluate the feasibility of the search fund model on Finnish market, the qualitative study aims to identify strengths and weaknesses perceived by potential Finnish searchers and investors. The study asks if Finnish market has enough potential searchers who have the required skills and traits, potential investors who would be willing to provide the required search and acquisition capital, and potential targets to support multiple search funds.

The study shows a market opportunity for no more than 4 to 8 searches annually in next ten years. Raising search stage funding is identified as a key bottleneck, which may be effectively mitigated by introducing a catalyst to champion the model.

Keywords search fund, search funds, entrepreneurship through acquisition, private equity, buy-out, feasibility study, entrepreneurship

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Tiivistelmä

Search fund on sijoitusinstrumentti, joka tarjoaa yrittäjäksi aikovalle mahdollisuuden etsiä,hankkia, johtaa ja kasvattaa yritystä. Vuoden 1983 jälkeen Yhdysvalloissa perustetut 258 search fundia ovat tuottaneet yhteensä 8.4 kertaisen sijoitetun pääoman tuoton ja 37% efektiivisen koron. Search fundeja on löydetty UK:sta, Espanjasta ja Saksasta, mutta ei toistaiseksi Pohjoismaista.

Search fund –malli lupaa hyötyjä sekä sijoittajille että yrittäjäksi aikoville. Sijoittajat voivat sijoittaa uransa alkuvaiheessa oleviin lahjakkuuksiin ja kasvupotentiaalisiin mikroyrityksiin, jotka eivät ole perinteisen privaty equity –mallin kannalta kiinnostavia kohteita. Yrittäjäksi aikovat voivat päästä toimitusjohtajaksi ja merkittäviksi osakkaiksi uransa alkuvaiheessa.

Tämä tutkielma arvioi Search fund -mallin soveltuvuutta Suomen markkinalle. Laadullinen tutkimus pyrkii tunnistamaan vahvuuksia ja heikkouksia, joita yrittäjäksi aikovat sekä sijoittajat havaitsevat mallissa. Tutkielma pyrkii selvittämään löytyykö Suomen markkinalta riittävästi yrittäjäksi aikovia, sijoittajia sekä kohteita useamman Search fundin tarpeisiin.

Tutkielma osoittaa markkinapotentiaalin 4-8 Search fundille seuraavan kymmenen vuoden aikana. Hakuvaiheen rahoituksen arvioidaan olevan keskeinen pullonkaula mallille. Tätä pullonkaulaa voidaan lievittää tuomalla markkinalle ”katalyytti”, joka vie mallia eteenpäin.

Avainsanat search fund, search funds, entrepreneurship through acquisition, private equity, buy-out, feasibility study, entrepreneurship

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1. Introduction

Search fund model provides “an aspiring entrepreneur with opportunity to search for, acquire, manage, and grow a company” (A Primer on Search Funds, 2013). Search fund process begins with a searcher, typically a recent MBA graduate, raising equity capital to fund a 12 to 36 month process of searching an ideal acquisition target. After discovering the target company, the searcher negotiates the transaction and becomes a CEO and partner of the company.

Originated by H. Irving Grousbeck of Stanford University's Graduate School of Business in 1984 (A Primer on Search Funds, 2013), the search fund model has provided phenomenal returns to both investors and entrepreneurs since its conception. This niche investment vehicle targets “the least efficient segment of private equity market”, namely micro-growth, where traditional private equity funds often have challenges to operate profitably (Johnson, 2015).

In U.S. and Canada, Stanford GSB (Pohlmeyer and Rosenthal, 2016) has identified 258 search funds, which have returned an aggregate ROI 8.4x and IRR 37%. IESE (Kolarova et al, 2016) has identified 48 international funds, mainly located in UK, Mexico, Spain, Brazil and Germany. However, no active search funds have yet been identified in the Nordic countries. Search Fund literature has not provided an answer on why the model is not employed on this market.

With 78.000 Finnish small and medium businesses having an owner-manager retiring within a decade (Haavisto, 2017), Finland is facing a succession problem. Out of the 78.000 owner-managers, 30.000 believe to sell their company outside of family, and 20.000 expect to pass their company inside the family (Varamäki et. al, 2015). Could this present a market opportunity for the search fund model to be employed in Finland?

1.1 Research Objectives

This study aims to examine the feasibility of the search fund model on Finnish market. The feasibility study follows the lines of Justis and Kriegsmann (1979): The focus is on exposing the strengths and weaknesses of the search fund model, and objectively assessing its prospects for success in the Finnish market. The study emphasizes what Justis and

Kriegsmann would call market research or market feasibility, which is arguably the most critical risk when introducing existing products (or in this case, models) to new markets.

How to determine if the search fund model feasible in the Finnish market? The key actors on search fund model are the searchers, investors, and owner-managers selling their businesses. To determine the prospects for success, we would need to understand if our (considerably smaller compared to the ones mentioned above) market have enough:

- Potential searchers who have the required skills and traits to search, acquire and grow businesses. Is the model attractive for experienced managers or entrepreneurs?
- Potential investors who would be willing to provide the required search and acquisition capital. Do they find the search funds to be attractive as an asset class?
- Potential target companies (matching a criteria) to support multiple search funds.

Adapting the Justis and Kriegsmann (1979) definition of a feasibility study, this study aims to shed light on the strengths and weaknesses perceived by the potential searchers and investors in the Finnish market. From the selling business owners' perspective, the model differs very little from other means of selling the business. Therefore, this study focuses on the market size of potential target companies instead of the perceptions of the sellers.

The research objective of this study is formalized into three research questions:

- RQ1: What strengths and weaknesses do potential Finnish searchers see in search funds as a career choice?
- RQ2: What strengths and weaknesses do potential Finnish investors see in search funds as an asset class?
- RQ3: What is the search fund market potential in Finland, and how many searches can it support?

1.2 Structure of the Thesis

This introduction is followed by the literature review chapter. The literature review aims to summarize the current body of knowledge on search funds, especially from the perspective of the three research questions. In addition, the literature review describes the theoretical frameworks and how they are used to develop hypotheses for the study.

Methodology chapter describes the overall research design and approach, as well as how and why the specific methods selected. Context and sampling, as well as how the data collection

and analysis methods were used is described in detail. The methodology chapter owes to Saija Katila and Johannes Gartner of Aalto University for introducing the author to the relevant tools and concepts of qualitative research. The chapter is closed with discussion of trustworthiness and ethical considerations.

The findings chapter outlines the key empirical findings of the study. Three of the highlighted themes are related to search funds as a career choice, and six focus on search funds as an asset class. The former are describing the findings related to potential searchers, and the latter focus on findings related to potential investors. The findings on potential targets and the market potential is covered already in the literature review section.

Discussion and conclusions aims to answer the research questions, and tie the answers to the findings in this study. Answers are also evaluated against the selected theoretical framework, and the wider search fund body of knowledge. The final chapter is closed with conclusions regarding the feasibility, and recommendations for both practical implementation and future research.

2. Literature review

The literature review aims to provide a description of the search fund model, and summarize the current body of knowledge on the topic. The review approaches the topic from three perspectives, based on the research questions. The review begins by evaluating search funds as a career choice and as an asset class, and closes with an estimate on the market size based on the number of potential acquisition targets in Finland.

All three perspectives are first approached with search fund literature typically describing the model on US market. Secondly, these US based findings and data is discussed in context of the Finnish market. Finally, by introducing selected theoretical frameworks, the three hypotheses regarding the feasibility on Finnish market are developed.

The literature review relied on recommended readings from Prof. Peter Kelly of Aalto University as a starting point. Recommendations included the often cited publications from Stanford GSB, IESE and Harvard Business Review. Majority of the cited search fund literature seems to consist of reports and online sources, as only few peer-reviewed articles were found with keywords “search fund model” or “entrepreneurship through acquisition”.

Out of the 35 results, only two peer-reviewed articles were found relevant for the study. After removing newspaper articles, case studies for educational purposes, and results not related to this specific search fund concept, only articles by Morrissette and Hines (2015) and Hunt and Fund (2012) remained.

Following an advice from Tapio Passinen of Tesi, the literature review was expanded through contacting the key authors on search funds, and requesting for any relevant additions to authors and publications in references. In total, seven of the authors responded to requests. As most of these authors described the reference list as exhaustive, the scope of the review was considered sufficient to the few received additions.

2.1 Introduction to Search Funds

Figure 1: The four stages of the search fund process (A Primer on Search Funds, 2013)

A search fund is described as an "investment vehicle that allows an aspiring entrepreneur the opportunity to search for, acquire, manage, and grow a company" (A Primer on Search Funds, 2013). Instead of starting up a new business from scratch, a search fund enables the entrepreneur to jump on established businesses with steady revenue and earnings.

Search fund model provides advantages for both investors and searchers (Johnson, 2015). Investors are able to invest in "least efficient segment of the private equity market (the micro-growth market)" and "high-caliber talent early in their career", backed by experienced investors. Searcher are able to become CEOs of running businesses with significant equity stake.

The search fund process has four stages: fundraising, search and acquisition, operation, and eventually an exit (A Primer on Search Funds, 2013). Essentially, "search fund is a pool of capital" allocated for the search stage. The search efforts of the entrepreneur is financially supported by the search fund, as modest salary and administrative costs are covered by the search capital.

Once the entrepreneur has found a target company and negotiated the acquisition, the entrepreneur raises additional capital for the acquisition. The search stage investors typically have a right of first refusal, and provide majority of the acquisition capital. Whether they decide to invest or not, their search fund capital is converted to shares of the target company. Returns are realized by growing and developing the company towards trade sale or other liquidity event.

Stanford GSB's search fund study has identified 258 funds in U.S. and Canada (Pohlmeyer and Rosenthal, 2016). The number of new funds is also on the rise: Over 9 funds are raised each year in U.S. and Canada since 2007, reaching peak levels in 2014 and 2015 with 38 and 43 new funds. In addition, IESE has identified 45 international search funds (Kolarova et al,

2016). Of these funds 12 were in the U.K., and 9 were in Continental Europe. However, no funds have been identified in the Nordic countries.

2.2 Search Fund as a Career Choice

Search Fund Data

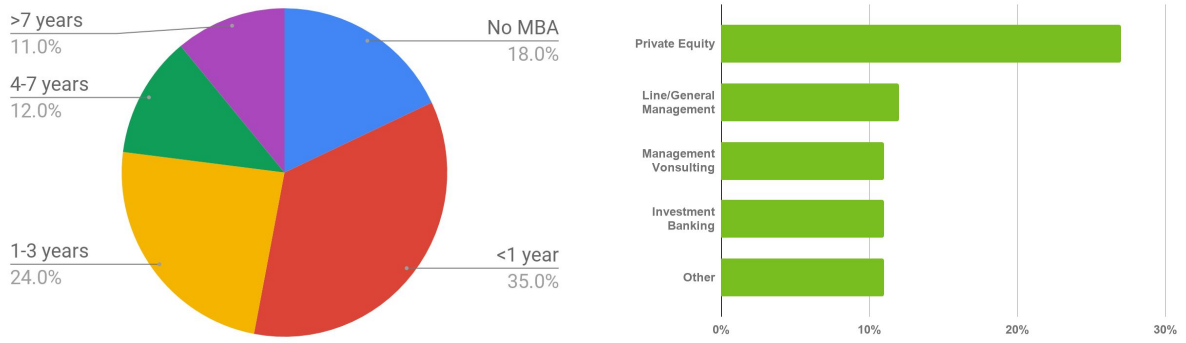

Figure 2: Post-MBA experience and professional background of North American searchers (Pohlmeyer and Rosenthal, 2016)

Most search fund entrepreneurs are "relatively young, recent business school graduates" (Pohlmeyer and Rosenthal, 2016). Some 60% of the entrepreneurs in new North American search funds raised in 2014-2015 had graduated from an MBA program within three years of raising their fund, and 73% were under 36 years old. Searchers are increasingly coming from schools other than Stanford, and more searchers are 3–5 years out of business school as often as newly-minted MBAs (Dennis and Laseca, 2016).

According to Pohlmeyer and Rosenthal (2016), "Searchers come from diverse backgrounds, although individuals with a private equity background represent the largest cohort with 27%. General/line management, management consulting, investment banking, and other represented the four next most common professional backgrounds for searchers".

Johnson (2015) points out how searchers have the opportunity to develop themselves as businesspersons. Through the search fund process, the searchers learn to assess and negotiate deals, raise bank debt, and deal with uncertainty. Search process also prevents the searcher from buying a bad business.

The recent MBA graduates are bearing a high opportunity cost by choosing the search funds: "Many post-MBA compensation packages include a high starting salary and a signing bonus, the principal of a search fund commands a relatively lower income" and uncertain upside

(Pohlmeyer and Rosenthal, 2016). The opportunity cost can be even higher for experienced managers with MBAs, which can explain the profile of relatively young graduates.

After studying unsuccessful search fund acquisitions, Kessler and Ellis (2012) have drawn recommendations regarding the qualities of the searcher. They claim that a successful searchers should be transparent and willing to work with their board of directors. They should be able to listen to their board, be willing to learn from the board, and have the humility to recognize and admit mistakes. The searchers needs to be able to adapt to a leadership position, retaining key employees, making appropriate hires and motivating the team.

Ruback and Yudkoff (2017) add a few additional desired skills and traits. To succeed at acquisition entrepreneurship, searchers need basic management skills, including understanding of finance. In addition, searchers need confidence and persuasive ability to project optimism towards business brokers, investors, sellers, and the employees and customers they inherit. They also need persistence, the "fortitude to bounce back" after hardships in both search and operation stages. Searchers need to be enthusiastic learners: In search stage they need "to quickly get up to speed on unfamiliar industries, sectors, and companies", and eventually become knowledgeable about the business they acquire.

Common motivations shared by those who raise search funds include "a desire to own, manage, and build a company" without starting the company around your own idea from the scratch (A Primer on Search Funds, 2013). They "desire to realize high financial upside" aiming for considerable returns for their investors and themselves, but also enjoy the search process as "they gain an experience of becoming immersed in multiple industries over a short period of time." Acquisition entrepreneurship can be considerably less risky path than founding a startup, while providing the professional independence rarely available in large companies (Ruback and Yudkoff 2017).

The Finnish Perspective

With limited number of MBA graduates, the Finnish searchers are more likely to hold other degrees, such as Master of Science in Technology or in Economics and Business Administration. To demonstrate the required skills and traits, the searchers are also likely to have some years of management experience before embarking on a funded search.

With a total of 35 000 alumni, Aalto university alumni network could present a source of prospective searchers. Majority of the alumni with management experience are likely to be

non-entrepreneurs employed in larger companies, with little or no previous entrepreneurial experience.

These experienced managers may be subject to stronger career and family handcuffs than recent MBA graduate. According to Wasserman (2012), social status, high salary, vesting schedule, spouses and children can reduce the likelihood of founding a startup. Similarly, these factors may prevent experienced managers to choose search funds as a career choice.

Startup companies could provide another source of Finnish searchers. As majority of the companies fail, there is a pool of experienced entrepreneurs constantly looking for new opportunities. These individuals often have the desired skills and traits, but more importantly, often weaker career handcuffs and built-in taste for professional independence.

Theory and Hypotheses

Shane and Venkataraman (2000) have pointed out that the decision of entrepreneur to exploit an opportunity is affected by nature of the opportunities and individual differences.

In order to exploit an opportunity, the entrepreneur needs to evaluate expected entrepreneurial profit to be more valuable than the opportunity cost of other alternatives, and provide additional premium for bearing uncertainty (Kirzner and Schumpeter, cited in Shane and Venkataraman, 2000). As the decision to exploit an opportunity is also influenced by individual's perceptions of the downside risk, the higher willingness to bear the risk influences the decision to exploit opportunities (Khilstrom, Laffont, and Knight, cited in Shane and Venkataraman, 2000).

The potential searchers with no entrepreneurial experience may have previously decided not to exploit entrepreneurial opportunities because of the perceived downside risk or low profit. However, search fund model appears to have lower survival and exit/liquidity risk (Hunt and Fund, 2012), but higher expected returns (Pohlmeyer and Rosenthal, 2016; Wiltbank and Brooks, 2016) than startups with angel investment. As search funds have the potential to provide more profitable and less riskier path to entrepreneurship, this lead us to the hypothesis:

> H1: Potential searchers see higher expected entrepreneurial profit, lower uncertainty and lower downside risk as search fund's advantage over startups.

If individuals have developed useful information for entrepreneurship from their previous employment, they are more likely to exploit entrepreneurial opportunities (Cooper, Woo, and

Dunkelberg, cited in Shane and Venkataraman, 2000). Prior entrepreneurial experience reduces learning costs related to exploitation, and therefore increases the probability of exploitation of entrepreneurial opportunity (Carroll & Mosakowski, cited in Shane and Venkataraman, 2000).

In addition, the desire for independence has been identified as a prime motivation for starting a business (Shane, Locke & Collins, 2003). Other entrepreneurial motivation traits do exists, such as locus of control and need for achievement, but these motivations have been identified amongst managers as well as founders. As potential searchers are expected to have reduced learning costs related to exploitation and higher desire for independence, the study makes a following hypothesis:

> H2: Potential searchers see independence and ability to leverage their experience as search fund's advantage over employment.

2.3 Search Fund as an Asset Class

Search Fund Data

As an asset class, search funds appear to outperform both VC start-up stage investments and angel investments in North America. Through end of year 2015, search funds tracked by Stanford GSB had achieved an aggregate ROI of 8.4x and an IRR of 36.7% (Pohlmeyer and Rosenthal, 2016). While angel investments in US were estimated to have an aggregate ROI of 2.5x and IRR of 22% (Wiltbank and Brooks, 2016), the VC start-up stage investments had to settle for aggregate ROI of 2.1x and IRR of 29%.

In addition to higher aggregate IRR returns, search funds display less survival risk and exit/liquidity risk (Hunt and Fund, 2012). Companies acquired through search funds have 90% survival rate, whereas companies backed by angel investments and start-up stage VC investments have significantly lower 35% survival rate. In 2005-2010, 12% of all search funds resulted in exits through strategic M&A with no IPOs. At the same time, only 4% of angel investments and 9% of start-up stage VC investments resulted in M&A or IPO.

The median search fund investment is profitable: 52% of the search funds result with capital gains for the investor (Pohlmeyer and Rosenthal, 2016). Out of these, 11% deliver ROI of over 5x. 27% of search funds result in no acquisition, and additional 21% in total or partial loss of

invested acquisition capital. In comparison, both the median angel investment and start-up stage VC investment result in loss (Hunt and Fund, 2012).

The average holding period of a company acquired through search fund process is seven years (Dennis and Laseca, 2016), reflecting the "investor's willingness to hold strong assets for the long term". The period is over 55% longer compared to an average angel investment holding period of 4.5 years, and even longer in relation to VC fund investments (Wiltbank and Brooks, 2016).

Private equity buyout funds share some operational similarities with search funds, but differs not only in the size of acquired companies, but also in performance: US based private equity buyout funds have delivered lower returns than search funds with ROI of 1.9x and IRR of 13.4% (Global Private Equity Report, 2017). Surprisingly, private equity displays only marginal reduction in survival risk and exit/liquidity risk: 37% of investments by PE funds lead to loss, including 8% leading to full loss of invested capital (A New Arrow in the Quiver, 2017). The focus on larger companies does not seem to proportionally lower the risk.

In U.S. and Canada based search funds, there are typically more than ten investors purchasing more than one unit of the search capital (Dennis and Laseca, 2016). There are usually 10 to 20 units in each fund, valued in the range of $15K to $40K per unit. The median search capital per entrepreneur in North America has grown from $262,500 in 2009 to $390,000 in 2015 (Pohlmeyer and Rosenthal, 2016).

In the acquisition stage, company valuations typically range from $5 million to $20 million (Pohlmeyer and Rosenthal, 2016). In Stanford GSB data, the median purchase price to EBITDA ratio was 5.8x, and the median price to sales ratio was 1.5x. According to Pohlmeyer and Rosenthal (2016), "the equity portion of the acquisition tends to range from $1 million to $10 million, which typically represents 40 to 75 percent of the total purchase price". Rest of the purchase is often funded with long term debt and seller financing. Total purchase price per investor typically varies from $100K to $1 million.

The searcher generally receives a 15-30 percent equity stake in the acquired company (A Primer on Search Funds, 2013). The investors in the search capital stage are rewarded with additional premium, as their "search capital is commonly stepped up by certain percentage (e.g., 50 percent)" when converted to target company shares. The post-acquisition ownership of a target company with a $5 million equity portion might be divided with 10 percent to search investors, 70 percent to acquisition investors and 20 percent to the entrepreneur.

	Search Fund	Business angel investment	VC start-up investment	Private equity buyout funds
Aggregate ROI	8.4x	2.5x	2.1x	1.9x
Aggregate IRR	36.7%	22%	29%	13.4%
Company survival rate	90%	35%	35%	92%
Exit rate	12%	4%	9%	NA
Return < 1x	48%	70%	NA	37%
Average holding period	7 years	4.5 years	3 years	5.2 years
Company valuation	$5 million to $20 million	$4 million (average)	NA	$100 million to $5 billion

Table 1: Search funds compared to other asset classes on US market (Pohlmeyer and Rosenthal, 2016; Wiltbank and Brooks, 2016; Hunt and Fund, 2012; Dennis and Laseca, 2016; Global Private Equity Report, 2017; A New Arrow in the Quiver, 2017)

The Finnish Perspective

From the perspective of Finnish angel investors, the investment sizes in North American search fund may seem large. As described above, search funds generally require individual investor to commit in the range of $15K to $40K to the search capital, and from $50K to $1 million to the acquisition capital. In contrast, the median investment of Finnish angel investor is only €20K (Finnish Business Angels Network, 2017). For many Finnish angel investors, a single search fund investment is likely to equal the whole angel investment portfolio.

In fact, the North American investment sizes are closer to the Venture Capital and Private Equity funds. In 2016, these funds invested €450M in over 350 Finnish portfolio companies (FVCA, 2018), while angel investments totaled to €53M in 324 companies in 2016 (Finnish Business Angels Network, 2017). Average investment size with venture funds was €590K, while buyout funds invested €6.3M on average.

As long term debt typically covers 40 to 75 percent of the acquisition price, banks are a key element of the Finnish search fund model. In addition to commercial banks, Finnvera, specialized financing company owned by the State of Finland, is active on the field of changes

of ownership and management transition. In 2016, Finnvera financed approximately 1,000 management transition with a total of 141 million euros (Finnvera, 2017).

Another source of funding for the acquisition stage can be seller financing. With seller financing, the purchase price can be paid in future installments, or the payments can be triggered based on pre-set events. The shares of the seller could also be converted to subordinated long term debt.

Theory and Hypothesis

Agency theory and incomplete contracting theory have been widely used to explain the relationship between entrepreneurs and investors (Lahti, 2008). In this study, the two theoretical frameworks are used to build predictions on how Finnish investors would perceive the opportunity to invest in search funds.

According to the agency theory, if both the agent (entrepreneur or searcher) and principal (investor) are utility maximizers, the agent may not always act in the best interests of the principal (Jensen & Mecklin, 1976). The opportunity for adverse selection arises from asymmetric information, where the principal does not know what the agent knows, and enables moral hazard, where the agent can use the information disparity for his own benefit.

To resolve the problem, both parties need to commit to agency costs: Principal may need to incur monitoring costs, such as due diligences and rigorous reporting. Agent may need to incur bonding costs, such as loan collaterals or vesting periods, to guarantee he is not going to take actions harmful for the principal. In practice, these contracts can rarely fully align the agent's decisions with the decisions that maximize the welfare of the principal. Jensen & Mecklin describe this third type of agency cost as the residual loss.

On the other hand, the incomplete contracting theory questions the rationality of contracts that incur monitoring and bonding costs (Lahti, 2008). Specifically, models of transaction costs and bounded rationality, neither considered in agency theory, highlight the contractual incompleteness. The transaction cost model suggest that the monitoring and bonding costs are likely to exceed the benefits that they can bring to the principal (Spier, cited in Lahti 2008). The bounded rationality model suggests that principals and agents are limited in their ability to evaluate and foresee all possible contingencies, making ex-ante contracts covering all contingencies unfeasible (Spier, Hart, Van Osnabrugge, cited in Lahti 2008).

Both theories have been used to analyze the funding decisions by angel investors, venture capital fund managers and bankers (Mason and Stark, 2010). Angel investors tend to behave more in the lines of incomplete contracting theory, placing greater emphasis on evaluating the entrepreneur/entrepreneurial team and investor fit instead of introducing bonding and monitoring costs. As fund managers are typically better informed and resourced, and in better position to incur post-investment agency costs, they can focus on market and financial issues instead of the entrepreneur in their evaluation. Bankers also rely on agency costs, focusing on collateral and in-depth financial analysis before the loan decision.

With the search fund model, the searcher enters into contract with investors twice: initially when raising the search stage investment, and later when raising funding for the acquisition. As there is no company (and in case of opportunistic search, often even no market) to analyze in the initial search stage, the investment opportunity needs to be solely evaluated through the searcher's plans and qualities. Essentially, the investor enters the negotiation with immense disparity in information: he is almost fully dependent on searcher as an information source.

Search stage investors assess the searcher's "search strategy, industry choices, company screening criteria, and planned search process", but also the "subjective traits" of the searcher (Johnson, 2015). According to Johnson, the traits include "intellectual horsepower, disciplined and rational thinker, problem-solver, prepared (vs. casual), good selling skills, good communicator, resourceful, entrepreneurial, demonstrated past success, shows willingness to listen, open and transparent, humble."

The standard Stanford GSB search fund model (A Primer on Search Funds, 2013) has very little post-ante monitoring and bonding costs built into it. After committing to the initial search stage funding, investor has little direct control over the searcher – as a principal, he or she can only try to influence on how and where the search is proceeding, but cannot pull the commitment back during the search. On the other hand, the searcher is getting his salary paid during the search process, may he or she be acting in the best interests of the investor or not.

However, having freshly graduated MBAs from top business schools as searchers can be seen as a bonding cost. These searchers are incurring a considerable opportunity cost by deciding to work for a search fund instead of taking a corporate position with sign-up bonuses and a six-figure annual salary. Through this opportunity cost, a searcher-MBA resulting with failed search will share also the downside with his search stage investors. This can also influence

the perceptions of Finnish investors, as the opportunity cost (following the standard Stanford GSB model) may be significantly lower for Finnish searchers.

On the other hand, the acquisition stage funding on the standard Stanford GSB search fund model (A Primer on Search Funds, 2013) has more elements of agency costs in place. Investors are typically taking board seats in the target company. Searchers are receiving a considerable equity stake in the target company, aligning their interests with their investor's interests. The equity is vested based on performance indicators, set in place by the investors. The senior lenders have low financing risk, thanks to the strong EBITDA and moderate leverage. Essentially, the model is rewarding searcher as an agent only after the investors have been rewarded.

It seems that the two stages of the search fund are following distinctively different logic: Search stage is declining towards incomplete contracting theory, avoiding monitoring and bonding costs in order to keep transaction costs low. Acquisition stage declines towards agency theory, emphasizing post-investment monitoring and bonding costs.

Lahti (2008) has researched the behaviour of Finnish business angels, using incomplete contracting and agency costs as theoretical frameworks. The research indicates that Finnish business angels are behaving "much in accordance with the principal agent approach of venture capitalists", being very selective and performing comprehensive due diligences. Combined with the findings of Mason and Stark on fund managers and bankers (2010), we can assume that Finnish fund managers and bankers are not likely to put less emphasis on the transaction costs, leading to the following hypothesis:

> H3: Potential investors in Finland are more attracted to invest in the acquisition stage compared to the search stage

2.4 Search Fund Market Potential

Search Fund Data

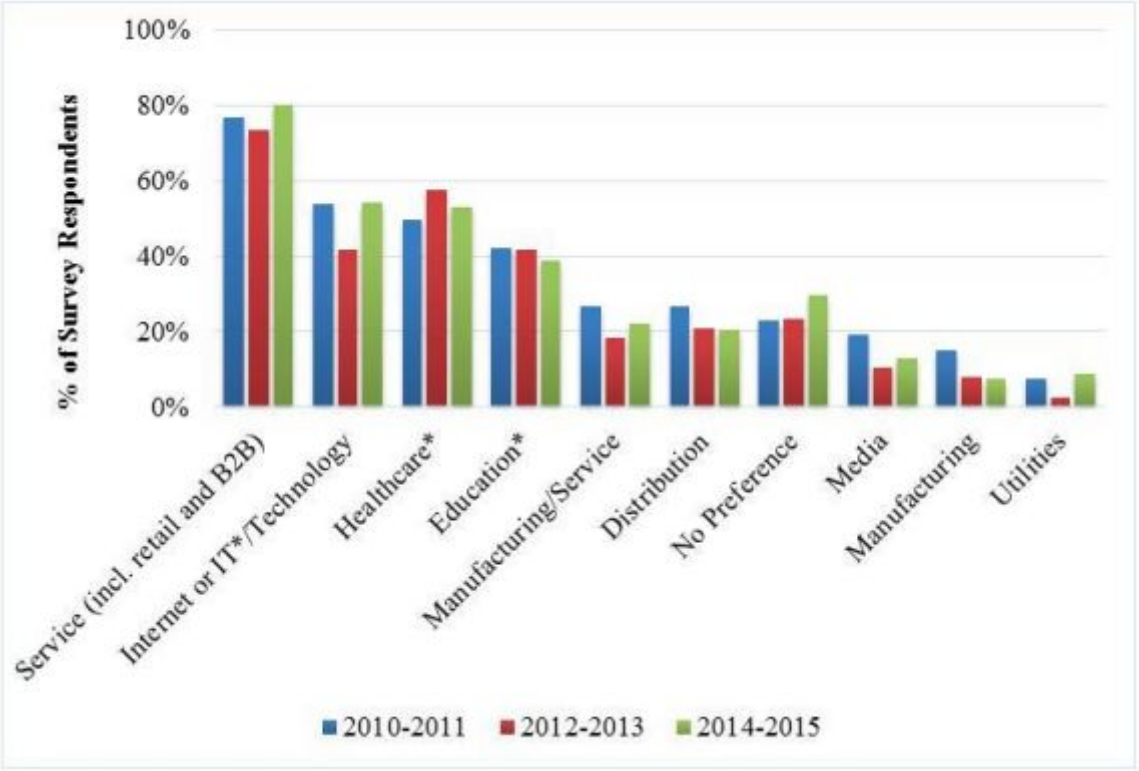

Figure 3: Most commonly targeted industries (Pohlmeyer and Rosenthal, 2016)

Search funds have often preferred business service firms more than other types, but recently, acquired companies come more often from other industries (Dennis and Laseca, 2016). The new industries include Internet/information technology (IT), healthcare, education, but also manufacturing (Figure 3).

The GSP Search Fund Primer presents a common set of criteria for target industries and companies (A Primer on Search Funds, 2013). Desirable industries are fragmented, growing and sizable, both in revenues and number of companies. They are relatively early in industry life cycle, have straightforward industry operations and high number of companies in target size range. Consolidated and declining industries, with limited barriers to entry and unpredictable exogenous factors, are deemed undesirable.

The company criteria focuses naturally on the health and sustainability of the business and its revenues (Kessler and Ellis, 2012). Solid middle management, customer base and competitive

advantage are desirable, but also recurring revenue model is perceived as an advantage. The seller is ideally motivated for non-business reasons: Ruback and Yudkoff (2017) point out retirement, poor health, divorce, inability of business partners to get along and death of the owner as common situations. The company also needs to have multiple avenues for growth, and a realistic liquidity options in 3-6 years.

The acquired companies have a median revenue of $7.2 million and $1.8 million of median EBITDA (Pohlmeyer and Rosenthal, 2016). Trailing annual EBITDA growth rate is 12 percent, and the median company has 45 employees. 25% of companies were purchased for $4 million to $8 million, 24% for $8 million to $12 million, and 39% for $12 million or more.

Johnson (2015) positions search funds as “too small for institutional investors and too large for most groups of angels”. In US market, “companies with EBITDA below $5 million are not attractive”, and something that is omitted by traditional private equity activities. This enables searchers to acquire companies with lower market multiples, and sell them with higher multiples once the companies have grown beyond $5M EBITDA.

One of the reasons why U.S. based search fund investors are enthusiastic of the model is the pool of available small businesses and the aging American demographic (Dennis and Laseca, 2016). Dennis and Laseca estimate over 220K businesses with between $5 to $50 million in revenue in the U.S., where 51% of business owners over the age of 55. That means that approximately 100K businesses, representing over $1 trillion of value (assuming an average EV of $10 million), will need some form of management transition and/or liquidity event in the next 10 years.

Primer on Search Funds (2013) describes a funnel for the search fund process. Based on Stanford GSB data, one successful acquisition required 500 identified companies in 2011, and 306 in 2009. With international search funds, “the mean number of companies reviewed before a successful acquisition” by single search fund totaled 216 (Figure 4) in 2014-2015 (Kolarova et al, 2016).

However, number of identified companies required for successful acquisition may be much larger. According to Kiessig and Chess (2013), Brown Robin Capital needed 2,000 first calls to brokers or business owners to complete the search. Best practices for the search phase -report (Stern, 2014) introduces a funnel where a searcher did 3,404 outbound postal mails, generating 256 responses, to secure 2 letters of intent. However for this case, there is no detailed information on the initial targeting for outbound mails.

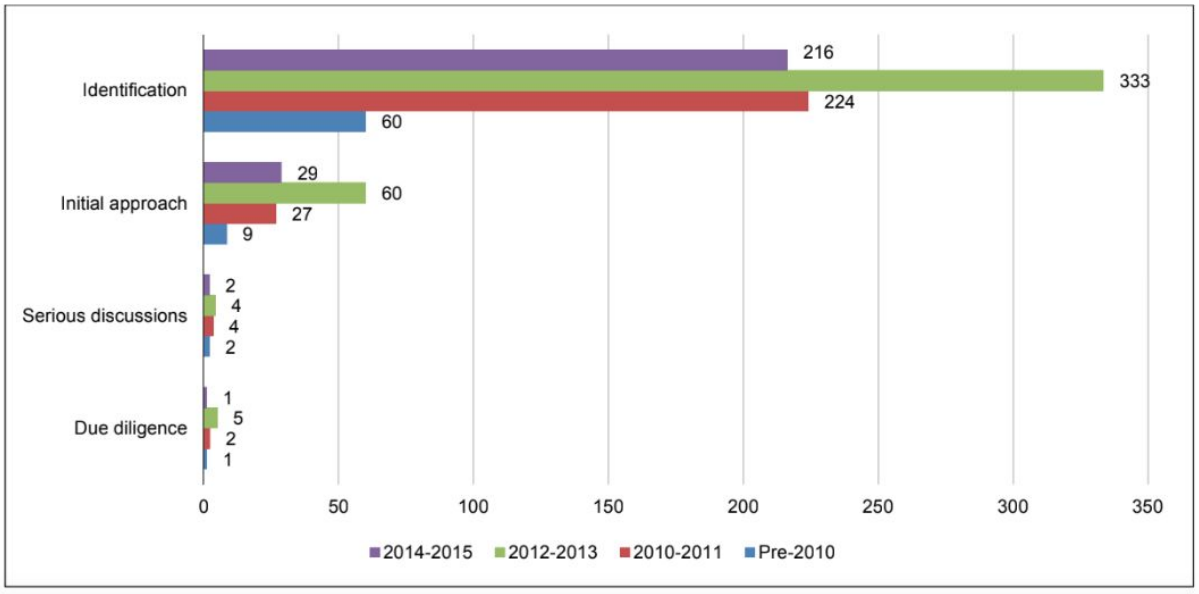

Figure 4: Search Fund funnel (Kolarova et al, 2016)

The Finnish Perspective

What would be the market potential on a considerably smaller market, such as the Finnish market? The Federation of Finnish Enterprises estimates that over 78k Finnish small and medium businesses have entrepreneur over 54 years, facing the retirement of the owner within a decade (Haavisto, 2017). The number represents 28% of total 283k Finnish companies, after agriculture, forestry and fishing have been excluded.

Out of the 78k entrepreneurs, 30k believe to sell their company outside of family, and 20k pass their company inside the family (Varamäki et. al, 2015). Federation has also published brokers, researchers, bankers' estimates of total of 35k actually realizing some type of business transfer within the next 10 years (Haavisto, 2017). Rest of the companies are expected to close down or fade away.

However, majority of the 78k companies are small. Varamäki et. al (2015) puts most of the companies in micro-category, with 86% employing 10 or less and 68% employing less than 5. In contrast, in US based search funds median sales at purchase is $7.2M and the smallest identified is $0.4M (Pohlmeyer and Rosenthal, 2016), making these Finnish micro-sized companies typically smaller than the targets in US. This should turn the Finnish searchers' focus to the remaining 14% and 11k companies.

On the other hand, the lower threshold for private equity and buyout funds may be smaller in Finland than in US. Table 2 lists five Finnish private equity / buyout general partners, known

of their focus to smaller companies. All of them have portfolio companies with less than €10M revenues, and two have even ones under €5M revenue. As only 10% of the total portfolio is in under €5M companies, and 40% in under €5M, the focus of the smaller private equity companies is clearly in the companies with revenues above mentioned.

The Orbis database (2018) identifies a total of 9,101 Finnish companies with between €5 to €50 million in revenue, while the Official Statistics of Finland (2015) identifies 2,731 companies in the revenue range of €10 to €40 million. The number represents some 1-3% of all Finnish companies, and compares to some 5% of the US market defined by Dennis and Laseca (2016).

However, the picture changes if the focus is shifted to lower range. Orbis identifies 20,906 companies between €1 to €5 million in revenue, and Official Statistics of Finland has 11,547 companies in revenue range of €2 to €10M. This focus would widen the universe of potential targets to 4-7% of all Finnish companies, and avoid bidding contests with private equity.

General partner	Portfolio companies with revenue < €10M	Portfolio companies with revenue < €5M	Smallest portfolio company name	Smallest company revenue
Evolver	5 out of 7	2 out of 7	Refix Ab	€2.5M
Helmet	7 out of 14	2 out of 14	Fifax Ab	€1.0M
Juuri	3 out of 10	0 out of 10	Puuha Group	€5.0M
Korona	4 out of 10	0 out of 10	Normiopaste	€5.4M
Vaaka	2 out of 11	1 out of 11	Evolta	€4M
Average	40%	10%		€3.6M

Table 2: Portfolios of Finnish private equity funds with focus to smaller companies (based on information published on the websites of the selected private equity funds)

Estimates on Finnish market

Table 3 presents three estimates of the market potential, and the number of searches Finnish market could sustain. There are three market definitions, ranging from wide to narrow. Wide definition includes all companies with €1-5M revenue, essentially bringing the lowest range from €5M in the Dennis and Laseca (2016) estimate to €1M to avoid bidding contests with private equity. Moderate definition is based on number of 54+ entrepreneurs (Haavisto,

2017) employing over 10 persons. The narrow focuses on €5-50M revenue bracket of Dennis and Laseca (2016).

Kessler and Ellis (2012) have made some recommendations on target financials. Target (or industry) should have a minimum of 10% growth rate, and a minimum of 10% EBITDA margin. After introducing this criteria to the previous Orbis result, a total of 5,323 companies remain in the wide €1-5M revenue bracket, and 1,699 in the narrow €5-50M range. Moderate market size is estimated to be in range of 2000 to 3000.

The number of searches is defined simply by dividing the number of targets with the 500 identified companies (Primer on Search Funds, 2013) or the 2,000 first calls (Stern, 2014) required for an acquisition. Presuming that market gets saturated search by search, ratios remain constant, and all searchers identify or contact a company only once, we get a wide ballpark estimate of 1 to 42 searches to cover the market.

As entrepreneurs are constantly getting older and entering the 54+ segment, the supply of potential targets replenishes in 10 years, assuming an average retirement age of 64. From this perspective, the estimate on number of searches needed to cover the market during a 10 year

Target market	Wide	Moderate	Narrow
Market definition	All companies with €1-5M revenue	54+ entrepreneurs employing over 10	All companies with €5-50M revenue
Companies in the target market	20,906	~11,000	9,101
Matching SF criteria of 10%+ EBITDA, 10%+ rev. growth	5,323	2000 to 3000	1,699
Targets covered by a single search	500 to 2000	500 to 2000	500 to 2000
Searches needed to cover all companies	10 to 42	6 to 22	5 to 18
Searches needed to cover companies matching SF criteria	3 to 11	1 to 6	1 to 4
Estimated annual potential acquisition volume for 10 years	€25M	-	€36M

Table 3: Estimated Search Fund market potential

period is assumed to be twice the amount above. When annualized, the Finnish market is estimated to sustain less than 8 new searches on wide target market, and less than 4 new searches on the narrow target market.

Assuming an average valuation of €10M for a narrow market company, and €3M for the wide market company, the maximum potential value of target companies and search fund acquisition would be €25M to €36M annually. Reaching the maximum potential would position the search fund market right next to startup angel investments, valued at €53M in 2016 and €26M in 2017, and crowdfunding valued at €34M in 2016 and €56M in 2017 (Finnish Business Angels Network, 2017).

For the scope of this study, the research question of "What is the search fund market potential, and how many searchers can it support?" has received a satisfactory answer through desk study only, and will be excluded from the empirical stages of the study.

2.5 Summary on Literature Review

The literature review and hypotheses can be summarized in the following perspectives:

As a career choice, search funds seem to attract individuals with a desire to "own, manage, and build a company" and "realize high financial upside" (A Primer on Search Funds, 2013). The searchers choose considerably lower downside risk compared to founding a startup, combined with professional independence rarely available in large companies (Ruback and Yudkoff, 2017). As these properties seem to increase the likelihood of individuals pursuing entrepreneurial opportunities (Shane and Venkataraman, 2000; Shane, Locke & Collins, 2003), two hypotheses related to potential Finnish searchers are developed:

- H1: Potential searchers see higher expected entrepreneurial profit, lower uncertainty and lower downside risk as search fund's advantage over startups.
- H2: Potential searchers see independence and ability to leverage their experience as search fund's advantage over employment.

As an asset class, search funds appear to outperform angel, early stage VC and private equity investments (Pohlmeyer and Rosenthal, 2016; Wiltbank and Brooks, 2016; Global Private Equity Report, 2017; Hunt and Fund, 2012; A New Arrow in the Quiver, 2017). However, search stage investments are likely to require investors to behave according to the incomplete contracting theory. As bankers (Mason and Stark, 2010) and Finnish angel investors (Lahti,

2008) tend to behave more according to the agency theory, the following hypothesis on potential investors is developed:

- H3: Potential investors in Finland are more attracted to invest in the acquisition stage compared to the search stage

Regarding the search fund market potential in Finland, the literature review is able to reach a satisfactory conclusion without proceeding to the empirical stage of the study. With total addressable market of 9,000 to 21,000 small and medium companies, the Finnish market is estimated to sustain less than 8 new searches on wide target market (companies with €1-5M revenue), and less than 4 new searches on the narrow target market (companies with €5-50M revenue).

3. Methodology

Methodology chapter begins with a description of overall design and approach, aiming to explain the research tradition the study is built upon. The rationale for the selected type of feasibility study and qualitative (instead of quantitative) approach is also given in the beginning of the chapter.

The chapter continues to describe the context of the study, and also the selected sampling strategies. Data collection and analysis methods provide the details of the study: Which methods were selected and why, and how the data was actually collected and analyzed. The chapter is closed with discussion of trustworthiness and ethical considerations.

3.1 Design and Approach

Feasibility study

In contrast to engineering and medicine, it appears that feasibility studies have somewhat less academic tradition within management studies. During the initial read-in stages, only a few feasibility studies were identified in peer reviewed journals such as Entrepreneurship Theory and Practice, Journal of Business Venturing and Journal of Small Business Management.

According to one of the more often cited articles by Justis and Kriegsmann (1979), a feasibility study can aid in business creation or expansion: “By presenting and analyzing all relevant information such a study can show the resources needed for a proposed venture, expose its strengths and weaknesses, and objectively assess its prospects for success.”

Approaching feasibility studies from construction development perspective, Young (1970) offers a definition in more simple terms: an economic feasibility of a development project is judged simply based on cost and value. The cost factors are generally studied first, including construction and operation costs. The value is estimated through market studies, by predicting demand and revenue. Only if the capitalized value exceeds the costs, the project is justified.

For this study, Youngs concepts of value and cost may be less purposeful. Instead of specific investment opportunity, the study is focusing on the feasibility of the overall search fund

model in Finnish market. To determine an exact value and cost as Young guides us, the study should focus on a single search fund investment case, and possibly on more limited pool of stakeholders. The results of this approach would likely be applicable only in very specific context.

Instead, this study follows the lines of Justis and Kriegsmann (1979): The focus is on exposing the strengths and weaknesses of the search fund model, and objectively assessing its prospects for success in the Finnish market. The study emphasizes what Justis and Kriegsmann would call market research or market feasibility, which is arguably the most critical risk when introducing existing products to new markets.

Young, Justis and Kriegsmann discuss the aims and content of a feasibility study, but offer little insight on the approach, designs and overall methodology. Feasibility studies seem to vary in approaches, ranging from desktop studies relying on existing data (e.g. Eronen, 2017) to qualitative (e.g. Lindqvist, 2016) and more quantitative ones (e.g. Shahin, 2011). There for, feasibility study as such does not limit the approaches a researcher can take. The approach selected for this specific study is described in detail in the next chapter.

Qualitative approach

This feasibility study follows a qualitative approach, "attempting to make sense of, or to interpret, phenomena in terms of the meanings people bring to them" (Denzin & Lincoln, 2000). The qualitative approach has been selected for three key reasons:

1. Research questions focus in the stakeholders' perceptions and insights regarding the feasibility of the search fund model. As qualitative study is aims to build a more holistic understanding of the research topic (Eriksson & Kovalainen, 2008), it should be suitable for capturing wider variety of the perceived strengths and weaknesses. In contrast, where quantitative approach could provide more structured and standardized data collection and analysis, it's theory-driven and fixed research design may lead to undesirably narrow focus and inflexibility.

2. Access and availability of data somewhat limits the research approach. As no search funds have been identified in Finland (Kolarova et al, 2016), the feasibility cannot be determined based on existing numeric data only. Therefore, numeric data collection would be effectively limited to surveys. With a rather marginal research topic, surveys are likely to face insufficient sample sizes, reducing the trustworthiness and usefulness of the results.

3. Search fund model doesn't currently seem to be very well known topic. To collect meaningful insights from various stakeholders, the study needs to first inform stakeholders of the search fund model. This requirement does not rule out the use of surveys as main data collection method, but may introduce uncontrolled variables, and fail to capture much of the data from spontaneous feedback of the stakeholders.

The study draws elements from a number of qualitative research traditions, of which action research is the most evident. The focus on solving a practical problem and the close collaboration with the research object are characteristic often associated to action research (Eriksson & Kovalainen, 2008). A feasibility study is also a great basis for action planning, implementation and evaluation, which are typical steps after data analysis in action research.

The theoretical perspective of the study follows constructivist, interpretivist and even phenomenological epistemologies. These perspectives assume that "the world does not present itself objectively to the observer, but is known through human experience, which is mediated by language" (Burr, cited in Eriksson & Kovalainen, 2008). From this perspective, the feasibility of the search fund model is merely a social construct: The research object exists only in the verbally expressed experiences of the research participants.

3.2 Context and Sampling

The context of the study is highly focused on the Finnish market, and on the feasibility of the search fund model described in the literature section. As the research instruments are based on the model, empirical results can hardly be generalized outside of this narrow context. For example, findings cannot be directly generalized to cover all models of entrepreneurship through acquisition, of which search fund is only a specific one.

However, in qualitative research, generalizability deals with representative samples (Yin, cited in Eriksson & Kovalainen, 2008). With well-grounded selection of participants, and a number of results supporting a previously developed theory, replication can be claimed through analytic generalization. Therefore, emphasis is on well-argued sampling.

Potential searchers sample

The key sampling strategy can be characterized as convenience sampling or backyard research, as the data collection began with organizations and individuals already familiar to the researcher (Glesne, cited in Eriksson & Kovalainen, 2008). The selected strategy lowers barriers for access and helps in developing more detailed contextual knowledge. As a

downside, the strategy may add additional bias: a backyard researcher may more easily mix normative beliefs and intuition with research evidence and facts.

Aalto alumni in Finance, Aalto alumni in industrial engineering and Haaga-Helia MBA students were selected to represent experienced managers that could be potential searchers. These groups were seen to provide best compromise in terms of access, volume and equivalence to the profile of international and U.S. based searchers.

1550 potential searchers received an email with brief description of the search fund model, and an invitation to an event where they could learn more and participate the study. In addition to the direct emails, some of the participants learned of the event though word-of-mouth and online channels. Total of 12 potential searchers participated the study.

Potential investors sample

With potential investors, the initial backyard sample was broadened with snowball sampling and purposeful sampling (Eriksson & Kovalainen, 2008). With snowball sampling, researcher interviews one person and asks her to name others that could be included in the study. Purposeful sampling relies on pre-selected criteria and lists of organizations and individuals to choose from.

In this study, Talouselämä Yrityskaupat -database (Talouselämä, 2018) was used to identify Finnish organizations who have recently been active in acquisitions of Finnish small and medium enterprises. Only organisations with finance as their primary industry (TOL 64-67) were selected for interviews. Expert opinions were used to select the most relevant individuals and organizations to participate.

Potential searchers	Potential investors
Four focus groups with: - 5 Aalto Alumni - 4 Haaga-Helia MBA students - 3 Others	Think aloud interviews with: - 2 Debt financiers - 2 Business angels - 2 Fund managers / Angel investors - 3 Family office managers - 3 Transaction advisors - 1 Institutional investor - 1 PE/Buyout fund manager - 1 Wealth management
12 Total	15 Total

Table 4: Sample of potential searchers and potential investors

45 potential investors received an email invitation to participate the study. Investors included Finnish business angels, fund managers, family offices, institutional investors and debt financiers (commercial banks). Total of 15 potential investors participated the study, out of which 7 were reached through backyard sampling, 3 through snowball sampling, and 5 through purposeful sampling.

3.3 Data Collection and Analysis

Wide range of data collection methods can be used in action research (Eriksson & Kovalainen, 2008). With the previously discussed limitations, i.e. lack of existing data and epistemological positions, focus groups and think-aloud interviews were selected as data collection methods. These methods also enabled the use of the broad body of knowledge on search fund model as research instruments.

Focus groups with potential searchers

Focus groups have been used in business research context to study consumer attitudes, needs and perceptions, but also experts', managers' and peoples' viewpoints and beliefs (Eriksson & Kovalainen, 2008). It is also one of the few research methods that emphasize interaction between participants, which can enable them to become "a forum for change". As the search fund model was likely to be relatively unknown to the participants, the interaction was expected to help participants in making sense and verbalizing their perceptions.

Focus groups can also encourage participation of individuals who are reluctant to be interviewed on their own (Eriksson & Kovalainen, 2008). On the other hand, some people may feel unwilling to discuss in a group, which might be the case when digging deeper on more sensitive topics. As motives for career choices can be sensitive, there is the possibility that participants were not too keen on discussing all topics.

The potential searchers were invited to Aalto University and Haaga-Helia UAS campuses for two hour events to learn about search fund model. The events started with an introduction to the search fund model (Appendix A), a case on entrepreneurship through acquisition (Appendix B), and continued as a facilitated focus groups for the last hour.

The participants were randomly divided to groups with 3 participants and one trained facilitator. Only few participants had met or knew each other before. Focus groups were given

a topic of “Search funds as a career choice”. The facilitators followed a predetermined interview guide, with following themes/questions:

1. Introduce the theme and context
2. Introduce the participants
3. What did you think about the case(s)?
4. As a career choice, how would you compare search fund to a startup?
5. As a career choice, how would you compare search fund to corporate job?
6. Could you see yourself as a principal of a search fund?
7. What would prevent you to become a search fund principal today?
8. Wrap up and summarize

The audio from focus group discussion was recorded with consent. No video was recorded.

Think-aloud interviews with potential investors

Think-aloud interviews enable participants to verbalize their thoughts, emerging as a task is being completed (Salkind, 2010). The method has been previously used in entrepreneurship studies, especially for understanding how various stakeholders evaluate investment and entrepreneurial opportunities (e.g. Mason and Stark, 2004; Read et. al., 2009).

In this study, potential investors were presented with investment memorandums of a fictional search fund cases (Appendices C, D and E). The participants were given a scenario, where their colleague would approach them with the memorandum, and ask their opinion on it before making an investment decision. Participants were then asked to think aloud how they would analyze the memorandums.

The case and memorandums were developed based on the existing search fund body of knowledge (e.g. A Primer on Search Funds, 2013), and early findings of this study from the focus groups with potential searchers. The target companies represented in the memorandums were pseudonymized Finnish companies, matching the criteria of successful search funds presented by Kessler and Ellis (2012). The case was further revised and developed after first interviews.

The search stage investment memorandums included:

1. Executive summary on search stage investment (2 pages)
2. Profiles of potential searcher candidates (1 page)
3. Budget for the search stage (1 page)

The acquisition stage investment memorandums included:

1. Executive summary on acquisition stage investment (2 pages)
2. Financial data on the target company (3-5 pages)

The interviewer protocol was rather unstructured, with the investment memorandums providing some pre-set themes for the interview. The interviewer presented some probing question throughout the interview, and answered the interviewees questions related to the search fund model.

The audio from think-aloud interviews was recorded with consent. No video was recorded.

Qualitative content analysis

The data was analyzed following the qualitative content analysis as formulated by Philipp Mayring (2014). Mayring describes the method as mixed method approach, where the assignment of categories to text is a qualitative step and the analysis of frequencies of categories a quantitative one.

Data is analyzed using more data-driven, explorative design instead of a theory driven, descriptive design. The design was selected to bring up the full variety of perceived strengths and weaknesses, instead of findings directly related to the theory. Categories were formulated inductively out of the text, instead of a theory based, deductively formulated category system.

A summarizing content analysis was used to reduce the material and create a comprehensive overview of the data. Data of potential searcher focus groups and potential investors' interviews were analyzed separately. In the first operation, recording unit was a single interview, and in the second the whole material. A paragraph was selected a coding unit for the first operation, and a paraphrase for the second round.

After these two operations, 2 main categories from potential searcher data and 7 main categories from potential investors emerged. Where appropriate, the frequencies of paraphrases under the main categories were presented in the findings.

3.4 Trustworthiness and Ethics

Conformability, credibility, dependability, and transferability

With constructivist qualitative research and subjectivist epistemology, classic evaluation criteria of validity, reliability and generalizability may not be suitable for evaluating trustworthiness. Eriksson & Kovalainen (2008) recommend using evaluation criteria that is more suitable for this constructivist and subjectivist philosophies. For this study, notions of conformability, credibility, dependability, and transferability (Lincoln and Guba, cited by Eriksson & Kovalainen 2008) are used to evaluate the trustworthiness.

Dependability is emphasized in the clear description of sampling strategies, data collection and analysis methods. In addition, all research instruments have been included as appendices to the study. This aims to make the research process as traceable and documented as possible.

Transferability is pursued through the selection of mainstream theoretical frameworks, such as the nature of entrepreneurial opportunities (Shane and Venkataraman, 2000), agency theory and incomplete contracting theory. The nature of the feasibility study is to reflect the findings with existing search fund literature and the Finnish market insights.

Credibility is built on various factors, including the comprehensive literature review on search fund topic. The findings are based on relatively large body of qualitative data, consisting of 4 focus groups and 15 interviews conducted for the purpose. In the findings chapter, links from observations to categories should be transparent, albeit the full breadth of data cannot be efficiently communicated.

Conformability, in terms of linking findings to the data may leave room for improvement. The selected data analysis method is rather subjective, and highly susceptible for various bias. Using triangulation of researchers on data analysis and category formation could have led to discovery of findings that may have been overlooked. Unfortunately, the scope of the thesis research did not allow triangulation.

Ethical considerations

Research ethics in qualitative business research is most often related to access and data-collection methods. Eriksson and Kovalainen (2008) point out how surprisingly little attention is given to the relationship between researcher and the researched person.

Elliot (cited in Eriksson and Kovalainen, 2008) identifies three different variations of general relationship between researcher and researched, and the ethical implications of the relationship. The researcher can be (A) detached and remains neutral, or (B) marginally participant, or (C) active participant enabling changes to take place.

With A-type relationships, ethical considerations can be seen as simply contractual ones. These include common practices such as voluntary participation and informed consent. For this specific study, all participants were invited with a written email describing the purpose and context of the research, and introducing stakeholders such as the sponsor of the study. The data was promised to be treated confidentially, and published only anonymously.

B/C-type relationships, typical for action research, bring up more complex ethical questions arising from close relations developing during the research project. In addition to anonymity of the informants, confidence creation, and "sensitivity and respect for the values and interests of those studied persons" become more relevant (Eriksson and Kovalainen, 2008).

The B/C-type relationships can become relevant after the feasibility study has been completed. In case the search funds are founded based on the study, informants may have interests and expectations for the implementation stage. However, the results of the study may or may not support the interests and expectations, and even fuel conflicting interests.

As there are no special ethical review boards monitoring ethical issues related to the topic, Aalto University Code of Academic Integrity and Handling Violations (Aalto University, 2013) and the guidelines of the Finnish Advisory Board on Research Integrity (TENK, 2012) are key ethical guidelines directing this study.

3.5 Summary on Research Methodology

The feasibility study follows the approach described by Justis and Kriegsmann (1979), focusing on exposing the strengths and weaknesses of the search fund model, and objectively assessing its prospects for success in the Finnish market. A qualitative approach, drawing

from action research tradition, is selected because of the nature of the research questions, access to data, availability of data, and the relatively low awareness of the subject matter.

Multiple sampling strategies were used for the study, and 12 potential searchers and 15 potential investors participating. Focus groups (Eriksson and Kovalainen, 2008) with potential searchers and think-aloud interviews (Salkind, 2010) with potential investors were conducted for data collection. Presentations and investment memorandums, based on search fund literature, were used as research instruments. The data was analyzed with summarizing qualitative content analysis (Mayring, 2014).

Following constructivist tradition, notions of conformability, credibility, dependability, and transferability (Lincoln and Guba, cited by Eriksson & Kovalainen 2008) were used to evaluate the trustworthiness. As the researcher is an active participant in this study, ethical considerations span beyond access and data collection methods (Elliot, cited by Eriksson & Kovalainen 2008).

4. Findings

This chapter presents the findings of the feasibility study. The findings are organized under nine main categories, identified through the inductive process of summarizing qualitative content analysis (Mayring, 2014). The hypotheses are tested after the findings related to the two open research questions have been presented.

First three categories are focusing on search funds as a career choice, aiming to shed light on RQ1 and the first two hypotheses: "Potential searchers see higher expected entrepreneurial profit, lower uncertainty and lower downside risk as search fund's advantage over startups" (H1) and "potential searchers see independence and ability to leverage their experience as search fund's advantage over employment" (H2).

The last six categories are focused on search funds as an asset class. These categories reflect the views of potential investors (RQ2) and test the third hypothesis, stating that "Potential investors in Finland are more attracted to invest in the acquisition stage compared to the search stage" (H3).

4.1 Search Fund as a Career Choice

Independence attracts to search funds, financial security to employment

After hearing two presentations (primer by Prof. Peter Kelly and a case study by the author) on search funds (Appendix A and B), the potential searchers were organized to focus groups. The focus groups were given a topic to discuss search funds as a potential career choice. Amongst other topics, potential searchers were asked to compare search funds to employment as a career choice.

Autonomy, freedom, and independent decision making were seen as advantage for search funds in three focus groups. A potential searcher mentioned how corporate politics would draw him towards search funds. Quite a few potential searchers mentioned how they are lacking opportunities for independent decision making in their current positions:

> *"At this point I would rather go to search fund, I have a corporate job and I am facing a challenge. Maybe it is the question of decision making, having more decision power in your own hand." (Focus group III, potential searcher #7)*

"I'm a manager in a restaurant. The owners are in their 50s and have retired, they are not very interested in new things and you don't start anything new anymore. I am feeling that I am stuck: I get to make a lot of decisions, but they are still the owners that I need to get approval from." (Focus group III, potential searcher #8)

"Search fund probably gives you that freedom in terms of how you do it. You do what is your own right and you have a target, and work the way that you see the target is achieved." (Focus group I, potential searcher #1)

Business owners getting better returns was mentioned in two focus groups. One focus group had a discussion starting from job security, pointing out that secure jobs in corporations are vanishing. And if there is no job security to begin with, why not make your own money without limited upside and equal risk?

"As an employee, you don't get that kind of return as you can get through owning a business" (focus group II, potential searcher #4)

Key disadvantage, shared by two focus groups, was financial insecurity. Employment was seen to give more security in terms of financials. Safe monthly salary was seen as difficult to let go, and the searcher was seen as a risk taker. On the other hand, one focus group discussed that search fund could actually provide better financial security with a 12-18 month contract. A searcher said that with an angel investor support, he would be willing to try.

	Perceived search fund advantages	Perceived search fund disadvantages
Compared to employment	More independence (n=3) Better returns (n=2) Opportunity to learn (n=1)	Financial insecurity (n=2)

Table 5: Perceived search fund advantages and disadvantages over employment and the number of focus groups with occurrences of the category

Return versus risk favors search funds over startups as a career choice

When compared to startups, Search funds were seen to provide better returns compared to risk in all four focus groups. Potential searchers were aware how raising funding for a startup can be a challenge, and how majority of startups go bad nevertheless. Factoring in the high chances of failing, search funds were seen as a more profitable option. Buying and old company was seen as less risky, and also better from time investment perspective:

"It doesn't probably make a huge difference if you are searching for a larger company or an idea to start your own business with. So if it takes the same time, but you have a larger vehicle to get into, it obviously should be more lucrative for you." (Focus group II, potential searcher #5)

"If you buy an older company that has customers, you will start making money faster than you would have in starting from the beginning." (Focus group III, potential searcher #7)

A focus group consisting of Aalto finance alumni discussed how good quality search and well done homework can lead to a very low risk position. Spending 1-2 years on finding a target company should result in much better target companies, than with a typical VC approach. Additionally, search fund path had less risk of diluting on follow-up equity rounds: in the end of the day, a searcher and startup founded can end up with equal shares of equity.

Operations being already up and running was mentioned as an advantage on three focus groups. Having customers, reputation and sales was seen as a way to avoid the "early stage grinding" and "tumbling in the dark" to discover a feasible business model. For a few potential searchers, these stage was also not seen as very inspiring professionally. One felt that he could leverage his experience in making business decisions better at an established company. In addition to more tangible features, a culture was also mentioned as an asset:

"This [search fund] is better: you have a running operation, with recurring revenue, you have some sort of place on the market, you have some assets, and if you are lucky, a culture of using those stuff in the right way." (Focus group I, potential searcher #1)

"Startup from the zero level is kind of scary, in that way you would think that this would be perhaps more secure way to buy an old company that has sort of a lot of customers, have sort of reputation." (Focus group III, potential searcher #8)

Search funds were also seen to provide more opportunities. Contrary to startups, search fund structure could be used for merging multiple businesses, and for generating returns through use of loan leverage only, without any growth. One of the potential searchers mentioned how startups were limited to your own ideas: with search fund approach, you would have a larger universe of opportunities to select of.

	Perceived search fund advantages	Perceived search fund disadvantages
Compared to starting a new business	Better return vs risk (n=4) Running operation (n=3) More opportunities (n=3) Leveraging skills (n=2)	Requires experience (n=2) Takeover risks (n=2) Less cool (n=1)

Table 6: Perceived search fund advantages and disadvantages over starting a new business and the number of focus groups with occurrences of the category

The ability to leverage skills with search funds was mentioned in two focus groups. The group consisting of Aalto finance alumni pointed out that their experience would enable them to analyze companies, to get funded for a good target, and focus on financial side that is often neglected in small companies. Another potential searcher referred to his leadership experience, which could be used to keep people on track in larger companies than startups

The focus groups resulted with considerably less disadvantages for search fund model. One focus group was not able to point out a single disadvantage, and another one came up only with search funds being "less cool at the bar" than startups. The idea was that startups are currently enjoying a "superhero mythos" compared to machine shops, which may be important for some startup founders - and also for some investors.

Main disadvantage compared to startups was the need of more experience and networks, which was mentioned in two interviews. Leadership skills, industry knowledge, finance and investment were seen as required skills for the searcher, and networks were seen important for finding co-founders and investors:

> *"Has to have a person that understand the business but also has the right kind of contacts." (Focus group IV, potential searcher #10)*

> *"You needs skills like leadership, management, a good seller, you need to be able to sell your ideas." (Focus group I, potential searcher #2)*

Risks related to takeover were mentioned also in two focus groups. Potential searchers thought that clients may disappear if they are too tied to the previous owner. The company may carry liabilities you are not aware of, unlike with a startup that enables you to get started on a clean sleet. A potential searcher also mentioned how business transfers can take many years, so getting to actually run the company might take more time than with startups.

Opportunity cost and lack of knowledge hold potential searchers back

Before closing the focus groups, participants were asked what would prevent them to become searchers today. The categories and subcategories of preventing factors identified from the focus group data is presented in the table (7).

Category of preventing factors	Sub-categories
Opportunity cost (n=4)	Current commitments (n=3) Needs to accept the risk (n=3)
Human capital (n=3)	Needs to know the model better (n=3) Lacks skills and experience (n=2) Lacks market knowledge (n=2)
Financial capital (n=2)	Personal finance (n=2)
Social capital (n=2)	Lacks networks Needs a team
Other (n=2)	Not a showman Family situation

Table 7: Perceived factors preventing potential searchers to start a search and the number of focus groups with occurrences of the category

Current commitments, such as a startup or a decent job, was mentioned in three focus groups. One potential searcher pointed out that he would need to give up current salary and carrying advance options to pursue search funds, which he felt increased his opportunity costs. Another one pointed out that current commitments prevent going for search today, but he may be interested in future:

> *"I may be a searcher, if the startup initiative doesn't turn out well." (Focus group IV, potential searcher #11)*

Accepting the risk was mentioned in three focus groups. One potential searcher mentioned that he clearly wasn't a risk taker, and another two mentioned the need for additional confidence to accept the risk. These can be also interpreted as an opportunity cost, where searchers have less risky and equally attractive career options.

Three focus groups mentioned that they would need to know search fund model / entrepreneurship through acquisition better before committing to it. Two focus groups mentioned needing leadership, management and sales skills, tools and experience on running a business. These also mentioned the need to know the market, industry and business environment better.

"I think I need a bit more experience about running businesses, but I feel I have the qualities that you would need for this. I am curious by nature, when I am interested in something I really get into it, I have determination, I am usually very good with people." (Focus group III, potential searcher #7)

"I'm interested, but I would need to know the market, the business, and have the right tools and confidence to proceed." (Focus group IV, potential searcher #10)

"Course on entrepreneurship through acquisition would be interesting." (Focus group II, potential searcher #6)

Two focus groups mentioned personal finance as a preventing factor. One participant considered needing a buffer of liquid funds before committing to a search. In addition to lack of financial capital, lack of networks and team members were mentioned in two focus groups:

"It is about finding a team. It is a cliché but nevertheless, finding a soulmate to look from different angle at the same stuff. So if you are a good leader, good with people and then you need to have another guy who is good with number. I am good communicator and get people along the track, but I'm not this sort of character who wakes up in the morning and okay P times 2 is this much and this much." (Focus group I, potential searcher #1)

One participant mentioned how he felt that he missed the "genes" to become a searcher. He felt that the position would require a person with more showmanship, being more convincing, and enjoying attention. One participant mentioned family situation as a preventing factor, although it also provided the opportunity to review next career choices:

"I am actually staying at home with my small child, focusing on that, and having actually another one on the way, so it is a natural point I think in my career to think what I want to be doing after all this." (Focus group II, potential searcher #6)

Hypotheses regarding search fund as a career choice

Based on the findings from focus groups, the first hypothesis of "potential searchers see higher expected entrepreneurial profit, lower uncertainty and lower downside risk as search fund's advantage over startups" receives fair amount of support. All four focus groups have occurrences of the category "better return vs risk" when comparing search funds to startups. In three of these focus groups, the categories of having a "running operation" and "more

opportunities" saw also occurrences. These two categories may be contributing factors to the perceived "better return vs risk".

Two of the focus groups had occurrences of the category "takeover risks". As takeover risks do not exist in startups, and increase uncertainty and downside risk, these occurrences may be interpreted as contradictory to the hypothesis. However, acknowledging their context, these occurrences should not be viewed as refuting the hypothesis, but merely to point out that search funds are not perceived as risk free.

The second hypothesis, "potential searchers see independence and ability to leverage their experience as search fund's advantage over employment" is also receiving support. Three of the four focus groups have occurrences of the category "more independence" when comparing search funds to employment.

Interestingly, the occurrences of the category of "human capital" in factors preventing participants to become searchers can be seen to provide support for the second hypothesis. In three focus groups, potential searchers "would need to know the model better", have additional "skills and experience" or "market knowledge". It might be that it is not the experience that attracts the searchers towards the search funds, but the lack of experience that keeps them away.

4.2 Search Fund as an Asset Class

Search fund returns, valuations and opportunities attract investors

In general, potential investors found the historical search fund returns to be very attractive. The aggregate IRR of 36.7% was perceived as much higher compared to what private equity investments can deliver. If a private equity fund would be able to deliver equally high returns, the carry interest was expected to be very high. However, one interviewee criticized the sample of US based search funds to be not relevant for the Finnish market.

The search fund acquisition multiples were seen as relatively low. Research instruments included sample memorandums on acquiring pseudonymized Finnish companies, with their valuations calculated using the average market multiples of US search fund acquisitions. The price-per-sales ratio of 1.0x and price-per-ebitda of 5.8x and 6.3x was described as well negotiated, especially if cash & cash equivalent was included in the price. An interviewee mentioned not seeing this low valuations since 2016, typical P/EBITDA being closer to 8x today. Another mentioned P/S of 1.5x and P/EBITDA of 8x as the upper limit for investors.

Potential investors saw market opportunities for Finnish search funds in:

- Targets too small for private equity, venture and buyout funds (8),
- Retiring founders and owner-managers facing business successions (5),
- Turnaround cases with financials not attractive to PE/BO/VC funds (2),
- Spin-offs from peripheral (non-core) business lines of larger companies (1), and
- Acquisition instrument for larger companies with entrepreneurial managers (1)

The targets too small for PE/BO/VC funds were mentioned as a potential market in eight interviews. Focusing on companies with revenues less than €10M was also seen to enable much larger universe of potential targets on the Finnish market. On the other hand, companies smaller than €2M to €5M in revenues were seen as challenging to take over.

Search funds would likely face competition from VC/PE/BO funds with target companies with enterprise value of €20M. There is thought to be less competition with EVs closer to €2M, resulting with market multiples even below P/EBITDA of 5x. However, some interviewees did mention PEs (namely Vaaka, Juuri, Helmet, Evolver and Korona) targeting also small companies with EV starting from €3M to €4M.

Retiring owner-managers facing business successions was discussed in five interviews. Business successions were seen as a potentially large source for target companies that have not reached their full potential under current management, are overlooking opportunities in digitalization or adjacent markets, and are not actively searched by traditional private equity funds.

Deviating from the Stanford GSB search criteria, two transaction advisors mentioned turnaround cases as an opportunity. The financials of these businesses are not attractive to VC/PE/BO funds, but can have growth opportunities, and may be turned profitable through operations streamlining and financial engineering. Turnaround businesses were seen to carry higher risks than the ones matching the Stanford GSB criteria, and would likely not enable the use of debt leverage. However, this could be attractive option for a self-funded searcher with good access to equity financing.

To widen the search and increase deal flow, the opportunity to focus on spin-offs was mentioned by one transaction advisor. By targeting smaller, peripheral business lines in larger companies, transactions can be faster and more straightforward in terms of due diligence. An interview also mentioned search fund model as a corporate internal opportunity: To enter a market through acquisition, a corporate having an entrepreneurial manager for the job could adapt the search fund model instead of hiring an investment bank.

One perspective on market was based on the options for the target business owner. Would he be more inclined towards selling to the searcher, or would he prefer selling to competitors or acquaintances? Would he consider business brokers, investment bankers or buyout funds? One advantage would be the promise of retaining jobs and operations locally, which can be a promise that business brokers, investment bankers and even buyout funds cannot give.

The ideal searcher is both experienced and an entrepreneur

The potential investors were presented with four profiles of potential searchers, and asked to evaluate the candidates. The profiles had been designed beforehand based on the attendees of the searcher focus groups. The think-aloud approach generated insights on specific searcher profiles, but also the following, more general themes:

- Searcher age and experience were seen to increase the chances of success,
- Previous entrepreneurial experience is seen as an advantage for a searcher,
- Professional managers can be more suitable for search funds than startups,
- Searcher needs a broad set of skills in business, finance and industry knowledge,
- Searcher should have skills that were not in the target company previously,
- Trust is seen as essential, and investor should know the searcher well, and
- A searcher is evaluated more carefully than a VC

Age and experience were seen to increase the searchers chances of success. Many potential investors saw young age and a short experience as a risk, although it was not a clear deal braked for the most. A family office manager mentioned seeing best results in companies with under 50 year old management, supported by board of directors in their 60s. A few were open also for investing in younger talent.

As the job of the searcher is an entrepreneurs' job, previous entrepreneurial experience was seen as an advantage. A fund manager said a searcher should not need to start learning what entrepreneurship is during the search. Having experience only from large corporations was seen as a risk. To increase credibility, the searcher should have a track record, ideally a successful exit. Essentially, the ideal searcher was seen to be a serial entrepreneur with history of successfully employing the search fund model. On the other hand, a transaction advisor pointed out that a professional manager can be more suitable to take the search fund path instead of founding a startup.

Ideal searcher was seen to have a multitude of skills. Searcher was seen to require both business and finance skills, and good command of accounting. Searcher was also expected to have experience on the targeted industry, or the specific stage of the target company life cycle. The search stage was seen to require quite specific resources and networks, which could be better described in the investment memorandums. A transaction advisor pointed out that a searcher should also have skills that were not in the target company previously, to be able to unlock some of the unused potential in the target company.

Searcher profile	Positive mentions	Negative mentions
Searcher A ● 30 year old ● MSc Econ. (Finance) ● 5 years of experience in investment banking and/or private equity	1	7
Searcher B ● 40 year old ● Bachelor of Hospitality Management, now studying MBA ● 20 years of industry experience specifically in catering and food industry ● 10 years of experience in management positions	5	2
Searcher C ● 40 year old ● Bachelor of Engineering, now studying MBA ● 20 years of multi-industry experience in management positions ● 10 years of entrepreneurial experience, including startup CEO	6	0
Searcher D ● 50 year old ● MBA, MSc Econ or Tech (Industrial Engineering) ● 25 years of multi-industry experience, director positions in TE 500 companies ● Also some entrepreneurial experience and/or VC fund management experience	7	2

Table 8: Number of negative and positive mentions per searcher profile

Trust was mentioned in quite a few interviews. Potential investors would be reluctant to invest in a searcher they do not know previously. To invest in search stage, investor should have great confidence in the searcher. Because of the double role of acquiring and running the company, a searcher will be evaluated more carefully than a VC. The searchers task was seen as more demanding than VCs, although a VC background was seen as favorable for a searcher.

Profile A generated the most negative mentions, varying from moderate considerations to an outright no. When analyzing the profile, potential investors noted a lack in experience, which was seen as a risk. Profile A was seen to lack substance, be more suitable as an analyst in the

search stage than CEO of the target, and being generally too young. A family office manager mentioned how profile A had seen only half of a business cycle during his experience. However, with the strong financial angle, the profile A might be having better focus than more technically oriented searchers.

Profile B was seen as a very industry focused, and suitable for a narrow search, although some interviewees criticized the experience to be too specific and not entrepreneurial. The key advantage of profile B was the industry knowledge: One of the transaction advisors pointed out how managers with 20 years of experience are the ones identifying opportunities on their industry. A senior lender mentioned how profile B could be suitable to run a target company with a revenue less than €10M.

Profile C was generally seen as a suitable candidate, with no negative mentions in the data. With the entrepreneurial experience, there was less need to do learning on the job. According to a fund manager, C was also seen as more likely to choose the entrepreneurial career for the right reasons. Some potential investors would've liked to have more information on how the startup did. Technical background was seen as generally well adaptable to a large number of businesses. However, a transaction advisor mentioned how some CEO-engineers might have the tendency to have an overt focus on product development.

Profile D was mentioned as the best, most low risk option by most interviewees. A senior lender mentioned how people have often accumulated a good understanding on leadership and managing people. The candidate was seen as suitable for running companies in the larger end of the search fund spectrum. On the other hand, profile D was seen maybe to have too much mileage and little appetite for the search. Profile D was expected to have less experience and interest for hands-on management of a small company.

Profile D was also seen more suitable for a self-funded search. A few potential investors pointed out that person with this profile should have been able to accumulate enough capital, to be able to fund the search stage with no external investors. A fund manager saw both C and D suitable for the job, but wondered why they would be interested pursuing a search fund instead of other opportunities.

To evaluate the searchers, a number of interviewees would've liked to have information beyond the experience, education and age. Does the searcher have the personal qualities of an entrepreneur? What is his motivation and vision he believes in? A transaction advisor pointed out that psychological tests used by Founder Institute may be suitable for screening

candidates with entrepreneurial traits. A family office manager was less interested in the background, but more curious about what the searcher wanted to do in his life.

Raising search capital is likely to be a struggle for most searchers

When analyzing a search capital investment memorandum (Appendix C), potential investors were struggling to find the value in investing during the search stage. As a manager with an institutional investor put it: Would the right of first refusal and step-up be sufficient reward for search stage funders? Would the high risk of losing the €15k ticket be worth it?

Potential investors identified a number of inherent risks in the search stage. If a suitable target is not found, the project ends and search capital is lost. The searcher may feel compelled to choose an inferior target when time starts running out. Generally risk is perceived to be very similar than in sports sponsorship: Is this the athlete that will go to Olympics or not?

Finding investors for the search stage capital was perceived to be a challenge by most of the potential investors. According to many interviewees, investors don't like to pay for the search, but for closing the deal. In a small market, the best private investors were thought to already have an access to the deals: If the deals are offered to them no matter what, will they see a value for paying for the search?

To make the search stage attractive, searcher should be very experienced and be able to provide access to deals that the investor would otherwise miss. One of the angel investors mentioned that investing in search stage would require a very experienced and networked team, and lot of convincing on how they can provide better access.

Many potential investors noted that the searcher carries no downside risk in the model. With the salary included in the search costs, failing to find a target will lead to only investor losing money. Sharing also risk instead of just the upside, and carrying an opportunity cost, would make the search stage investment more attractive.

Confidence in the searcher can increase, if he invests also himself in the search stage. 100% self-funded search makes the searcher even more credible for the acquisition stage. A family office manager also pointed out that a searcher could be spending his time better and probably getting a better acquisition deal without raising any capital for the search stage. Investors appear to be more willing to invest after a target company has been found.

The findings above seem to lead us to a paradox: To be a credible searcher, with experience and networks to attract search stage investments, you should have accumulated the financial resources for a self-funded search, and be willing to use those resources.

A single searcher also increases a key person risk, which can be reduced with a team. However, more than one searcher limits the search to larger target companies that can carry the additional salary expenses. This was also seen to introduce the risk of the searchers quarreling.

Search durations can also be quite long, longer than investors may like to fund. The 18 month duration presented in the memorandum was perceived both as too short and too long. At the longer end finding a reasonably priced target was thought to take 2-3 years, especially because the searcher was seen to start the search with a clean slate.

The search budget of the investment memorandum was seen as quite generous. The travel, office and marketing expenses were seen as unnecessary, especially for a one person searching in Finland. The searcher draw or salary was also seen as moderate, although interviewees did mention it should be lower than market salaries for the searcher. In general, external costs were seen as more acceptable than salaries.

The cost of due diligence (DD) raised different opinions. The interviewees agreed that full DD could not be covered with the budgeted €10k, as the minimum DD expense was estimated to be from €30k to €60k even in smaller companies. However, there were different takes on at what stage the DD costs should be covered.

If full DD costs were to be included in the search budget, the search fund would need to budget a limited number of DDs. A fund manager mentioned that for one acquisition a searcher might need to conduct up to six DDs. After running out of DD budget, searcher would need to raise additional search funding, choose less than ideal target, or close the search.

Full DD costs could also be funded separately. With this option, search stage would result only with a letter of intent. The acquisition stage investors would need to commit to DD costs in addition to acquisition capital. For at least three interviewees, this approach was seen as reasonable, but at least one family office manager would prefer to have the DD done beforehand.

Search stage was also analyzed from perspective of transaction costs: With the €150k search budget and additional due diligence costs, the target company EV was expected to be much closer to €20M than €2M.

When discussed on profiles of potential search stage investors, family and friends rounds, and also crowdfunding was mentioned as potential sources for search stage funding. Search funds were also seen as potential sourcing tool for smaller family offices and business angels, without their own search capabilities. Descriptively, one family office manager mentioned that they were currently moving from opportunistic investing towards more active search.

Senior lenders saw the search stage capital clearly as equity, not debt financing from banks. As one of senior lenders put it, they are only investing against foreseeable future cash flows, which are non-existing in the search stage. From financing perspective, he compared the search stage to game or other high-risk product development.

Search fund acquisition differs little from PE, growth is expected

Potential investors were asked to analyze two executive summaries of acquisition stage investment memorandums (appendices). The summaries included target company descriptions and planned post-acquisition strategies. Potential investors were asked to think out loud when evaluating the two memorandums.

When evaluating the target companies, potential investors mentioned following items:

- Previous owners: Who are the previous owners, and why they have the need to sell? Why have they not done what should be done to utilize the full potential?
- Market study: How is the market developing? How will the company be able to benefit of the market growth? Are there entry barriers that benefit the company?
- Dependencies and risks: How dependent is the company on key customers and suppliers? Are there risks in the environment? Any other business and credit risks?
- Financial analysis: How much debt do the companies currently have? Is there cyclic variation in the revenues? What kind of cash flows has the company been creating?

When evaluating the post-acquisition strategy, potential investors mentioned the following:

- Growth plan: Why would the company be more valuable in new hands? Where does the growth come? What is the growth potential, and the new role of the company in the market? How would executing the growth plan affect the company cash flows in different scenarios?

- Overtake plan: How will the overtake happen? What skills does the team have? How will the management and organization change? What assets will be liquidated?
- Exit plan: Is there a consolidation game going on? Who is buying and why?

A family office manager thought of the executive summary as suitable for raising interest, making the reader curious to read more. However, he (and few others) would expect to have a full business plan and market study prepared during the search stage.

In general, the sample companies were seen as attractive acquisition targets. A transaction advisor mentioned he would be happy to invest his own money in the Liquid Partners deal with the given price. Another said that he would be happy to recommend Blast Proof deal for friends and customers.

Most of the potential investors emphasized the company growth in their evaluations. The current revenue and profitability was seen as a baseline, on which a growth strategy would be built on. As one fund manager put it, these companies are engines running like a top. There's nothing wrong in them, they are just naturally aspirated, when they could be pressure charged.

Potential investors were also asked to analyze the transaction structure, detailing how the acquisition would be funded. With both companies, the stock purchase price was covered with 50% senior debt, 20% as equity, 20% subordinated debt and 10% of seller financing. The structure was adapted from the search fund literature.

Generally, the presented structure was seen as a very typical for the private equity world. The key differences were the small size of the company in the lower end of the search fund spectrum (EV €2M), and the lack of private equity general partner representing the majority shareholder from senior lenders perspective. Otherwise there seemed to be little difference if the company is found by PE or searcher.

The use of 50% of senior debt was seen as a moderate. Both of the interviewed senior lenders describe the funding structure and the target company fundamentals as attractive as and better than typical for banks. A fund manager noted that typically PEs take as much debt as they can, minimizing the need of equity. On the other hand, a family office manager and an angel investor wanted to keep the debt moderate. For the family office manager, the investment should be about operational excellence instead of financial engineering, and low or moderate senior debt would make negotiating with the bank easier.

However, with the lack of PE general partner, all senior lenders were less confident that shareholders will provide additional equity if needed. Without general partner and lead investor looking after its reputation, banks face the risk of equity investors walking away when target company faces challenges. With the searcher typically not investing substantially and having only 10-30% of ownership, he was seen to less likely have the same means and motivation to provide additional equity, as a PE general partner would.

The equity portion for a target of EV €2M was seen as quite easy to raise, the EV €20M target being more difficult, requiring family offices, institutional investors or PE funds. The size of the target company was seen as quite relevant from family office perspective: The target company closer to EV €2M than €20M can be too small to larger family offices. For one family office manager, even the EV €20M company was slightly too small to invest in.

The minimum investment range of a family office can also introduce controlling interest that differs from the search fund model. In case of smaller companies, minimum investments in range of €1M to €10M forces the family offices to become a majority shareholder, effectively controlling the company instead of the searcher. If target is in EV 20M, valuation is enough to have smaller family offices as minority holders.

The family office managers, with suitable minimum investment ranges, saw the acquisition stage proposals as interesting and potentially fundable. A family office manager noted that the six year holding period is suitable and realistic, and the transaction costs (incurred from the search stage) are relatively inexpensive, if the target is closer to EV €20M. He pointed out how they are avoiding direct startup investments, but also fund management costs. Direct investments to companies with moderate risk would be an attractive alternative to him.

The seller financing can come in various forms, and was not detailed in the transaction structure. A transaction advisor noted that an earn out or small equity share held by previous owner may support smooth transition. From his perspective, a seller could retain even a 20% equity share, reducing the need for additional equity.

A shareholder agreement was mentioned in two interviews. A transaction advisor pointed out that investors will want to tie the searcher to the company in a way or another. In addition to own investment, this could be done with vesting schedule and bad leaver terms. A family office manager saw that with multiple investors, he would have less control also on the terms of the shareholder agreement, potentially favoring the searcher.

A transaction advisor noted that the search fund model is focused on raising acquisition capital. Small companies often lack capital required for future growth, but the acquisition memorandum omits this aspect. Taking in account the previous finding of investors' growth appetite, and the opportunity for acquisitive growth, this perspective may need to be included into the search fund model.

Search funds are seen as angel investment class to Finnish private equity

Throughout the interviews, potential investors were often spontaneously comparing search funds to private equity as an asset class. On the other hand the investment unit sizes, especially with the smaller targets closer to EV €2M, were associated with angel investments.

In four interviews, the potential investors described search funds as an angel investment class for private equity or buyout world. The relationship was compared to stages of angel and VC investments in startups. A fund manager went on thinking out loud a value chain, where search funds could grow companies to be attractive to national level PEs and buyout funds, looking forward to exit the companies to Nordic and international funds.

With smaller targets closer to EV €2M, the whole transaction was seen as fundable with €100-150k business angel tickets and Finnvera guarantees and junior loans. A family office manager described that the equity for Fluid partners could be raised from family and friends, and a fund manager mentioned how angel investor consortiums would be interested. A private banker mentioned how he would be interested on marketing Fluid partners to his customers. Four potential investors mentioned that they would be interested in investing as private individuals.

A transaction advisor pointed out that search stage investment could be attractive to legal, finance or PR service providers. The model enables them to take more strategic position in a business that normally. In addition, search stage investment would enable the angel investors to influence the focus of the search can be influenced by the investors.

Despite the (previously covered) considerations of investing in the search stage, the target companies were generally seen as attractive alternatives for startup angel investments. Beside the obvious lower downside risk, potential investors saw advantages in the opportunity for active sourcing in search stage, and the lower risk for investment turning in to a millstone. The lack of novelty and limited upside risks were seen as the only disadvantages.

	Perceived search fund advantages	Perceived search fund disadvantages
Compared to startup angel investments	Active sourcing in search stage (4) No millstones in search stage (2) Lower downside risk (2) Lower risk for dilution (1)	Less novelty (1) Limited upside (1)
Compared to private equity investments	Case-by-case commitment (4) Entrepreneur as starting point (3) 10-30% searcher equity (4) Search and DD costs covered (1)	No diversification (4) One-time-only (3) Married to management (3) 10-30% searcher equity (1)

Table 9: Search fund advantages and disadvantages compared to Angel investments and PE with number of interviews these advantages and disadvantages were mentioned.

In four interviews, search funds were seen as a sourcing model for angel investors. A fund manager described how angel investors rarely have the resources for active search, unlike larger family offices and PE general partners. Instead, startup entrepreneurs are approaching them with proposals of varying quality. With the search fund model, searcher is actively searching and screening proposals for the benefit of the investor. As an institutional investor pointed out, a searcher should be more cost efficient than angel investor or hired analyst.

Compared to startups, search fund targets were seen as less risky as they are already profitable. Search funds were perceived to have smaller downside risk of losing the invested capital. A fund manager pointed out that in the worst case a business matching the search fund criteria would be as valuable in exit as it was when acquired.

In the search stage, investment not becoming a millstone was also seen as an advantage. As a transaction advisor mentioned, even if a suitable target is not found, the search stage investment is not dragging you, you just underwrite and forget it. In comparison, startups often require follow-up investments.

A transaction advisor described how the initial search stage investment would be a nice alternative for diluting or losing your investment with a startup, or spraying your investment to overpriced equity crowdfunding projects.

When compared to private equity investments, case-by-case commitments (with search and DD costs covered) and having the entrepreneur as a starting point were seen as advantages. The lack of diversification, the one-time-only nature, and being married to the management were seen as disadvantages, partly carrying opposite view. The 10-30% searcher equity received a mixed feedback.

In four interviews, case-by-case investments through right of first refusal were mentioned as attractive compared to traditional PE funds. The search fund model runs with lower committed capital, and provides the investor with an opportunity to choose whether to invest or not on a case. PE's rarely offer this opportunity. A fund manager explained how she had previously run a PE with case-by-case investment decisions, and had an issue with covering search and DD costs on deals that didn't realize. Search stage funding would solve this issue.

Having entrepreneur as the starting point, in comparison to PE model, was seen as smart in four interviews. A transaction advisor pointed out the advantage of focusing on finding a target company, not on finding both the target and the suitable management. A family office manager mentioned incentives being well aligned if searcher if searching for a company for himself to manage and own.

On the other hand, being married to management was seen as a disadvantage in three other interviews. As PEs can find the best management for a target, search fund lacks this opportunity. With up to 30% searcher ownership and minority shareholders, the searcher has control of the company instead of a PE general partner. For example, changing the management can be a challenge. However, a family office manager pointed out how PEs might struggle to find good management for companies with EV of €2M.

Another disadvantage compared to PE model is that a search fund has no diversification, as it acquires only one target company. An institutional investor mentioned that instead of investing in just one searcher, some investors could be more happy to invest in five. An angel investor pointed out that with the equal sums required for investing in one search fund target, he could invest in a number of startups

In addition, the one-time-only approach was seen as limiting the growth potential of the fund in one interview. Two potential investors also worried that the one-time-only nature can make the model less interesting for some investors, as there is less continuity and limited scope.

The 10-30% searcher equity share was seen mostly as reasonable reward. A fund manager pointed out that the share was well in line with the startup world. For him, it was not uncommon for entrepreneurs having a majority share after raising similar amounts of equity, and without investing themselves. With search fund model, a holding company structure was discussed to enable a desired asymmetry between investors and searchers.

Only one fund manager mentioned the 10-30% equity share to be quite high, compared to typical PE management rewards. However, it is worth noting that search fund model is not paying any additional carried interest, which should be considered to include in the 10-30%. Also the typically larger company sizes account in the difference in management equity.

A catalyst is needed to create a phenomenon out of search funds

Most of the potential investors (8) pointed out that a catalyst is required for a Finnish search fund model. An institutional investor pointed out, that the successful model in Stanford may rely on the strong alumni network, with the alumni having capabilities to invest in searchers. There might be a need for the catalyst taking the role of Stanford GSB, raising awareness and creating a phenomenon of the model on Finnish market. Without a catalyst, searchers are less likely to emerge, and investors can be less attracted to an obscure model.

In addition to awareness, the catalyst could provide structure, tools and a streamlined process to make the search more efficient. The transaction advisors mentioned that common tools for the searcher can make the search period shorter. These tools can include tools for search and analysis, legal and financial documentation, templates and guidelines, but also support services such as tax, legal and financial DDs.

A fund manager suggested that matching searchers with investors would lower the barrier of finding interested investors. He referred to Sitra being one if the instigators of Finnish Business Angel Network, which matched 650 angel investors with 400 startups in 2016 (Finnish Business Angel Network, 2017). A transaction advisor saw the task of finding investors willing to invest €150k units the hardest part. As a solution, a few potential investors suggested public funding already for the search stage in order to attract private investments.

The catalyst can be either private, or typically for the Finnish ecosystem, a public entity. The potential investors mention the following private entities as an option:

- Private equity fund, with a €10M allocation for search fund investments,
- Family office, with required public backing for multiple search funds,
- Crowdfunding platform, with a good reach to potential angel investors, and
- Accelerator or incubator, with a wide reach of mentors and/or investors

A public entity was also seen as suitable catalyst, with more neutral position and wider reach. The following entities and opportunities were mentioned in interviews:

- Tekes, by providing Kiito/Tempo like grant (max €50k and 50%) for the search stage,
- Sitra, by taking a similar role as with Finnish Business Angel Network previously,
- Tesi, by funding 10 search stages, and the resulting acquisitions with €1M each, and
- Aalto, by engaging their Alumni network with the search fund model

Hypothesis regarding search fund as an asset class

The third hypothesis, "potential investors are more attracted to invest in the acquisition stage compared to the search stage" receives strong support. The potential investors identified a number of inherent risks regarding search stage investments. Many felt that they already had an access to the deals, and saw no point in paying for the sourcing of the deals. The model where investor carries all downside risk and searcher none of it was also seen as unbalanced.

On the other hand, the acquisition stage was seen as very similar to traditional private equity investments. As the search fund returns, valuations, and opportunities were seen as attractive, number of investors were interested in the acquisition stage investments.

4.3 Summary on Findings

The findings of the feasibility study can be summarizes with the nine main categories:

- Independence attracts to search funds, financial security to employment
- Return versus risk favors search funds over startups as a career choice
- Opportunity cost and lack of knowledge hold potential searchers back
- Search fund returns, valuations and opportunities are attractive to investors
- The ideal searcher is both experienced and an entrepreneur
- Raising search capital is likely to be a struggle for most searchers
- Search fund acquisition differs little from PE, growth is expected
- Search funds are seen as angel investment class to Finnish private equity
- A catalyst is needed to create a phenomenon out of search funds

Based on the findings the first two hypotheses “Potential searchers see higher expected entrepreneurial profit, lower uncertainty and lower downside risk as search fund’s advantage over startups” (H1) and “potential searchers see independence and ability to leverage their experience as search fund’s advantage over employment” (H2) are receiving support.

The third hypothesis of “potential investors are more attracted to invest in the acquisition stage compared to the search stage” (H3) receives strong support. Search fund returns, valuations and opportunities are attractive to investors, but raising search capital is likely to be a struggle for most searchers.

5. Discussion and Conclusions

The discussions and conclusions chapter aims to answer the research questions, summarize and discuss the results with the previously covered literature. The chapter begins with Discussion on Search Funds as a Career Choice and as an asset class. The conclusions focus on the practical implications of the results, as appropriate for a feasibility study. The chapter is closed with limitations of the research and recommendations for further research.

5.1 Discussion on Search Funds as a Career Choice

The first research questions for the feasibility study was formalized as "What strengths and weaknesses do potential searchers see in search funds as a career choice?" Based on the literature review and theoretical framework provided by Shane and Venkataraman (2000), two hypotheses were developed. These two hypotheses made predictions on how potential searchers would evaluate the search fund instrument, compared to founding a startup and employment.

The first hypothesis, stating that "potential searchers see higher expected entrepreneurial profit, lower uncertainty and lower downside risk as search fund's advantage over startups", is receiving support from the findings. When compared to startups, potential searchers saw search funds as providing better returns with lower risk for the entrepreneur. Potential searchers acknowledged that most startups fail, and that the "early grinding" of finding a sustainable business model can be a struggle. Having a running operation in the acquired company seems to be the key enabler for these advantages.

However, some of the potential searchers were held back because of current commitments, such as a startup or a decent job, financial security offered by employment. In addition, search fund model was seen to introduce takeover risks that are not present in the startup path. These weaknesses can be seen as opportunity costs that the searcher needs to incur. The potential searchers appeared to evaluate expected entrepreneurial profit against opportunity cost of choosing startup path, but also of the one with employment. The searchers attitudes seem to be well in line with the theories of Kirzner and Schumpeter (cited in Shane and Venkataraman, 2000) on pursuing entrepreneurial opportunities.

The second hypothesis of "potential searchers see independence and ability to leverage their experience as search fund's advantage over employment" received also some support.

Potential searchers recognized autonomy, freedom, and independent decision making in search funds to be the key advantages over employment, as predicted by Shane, Locke & Collins (2003) on their article regarding entrepreneurial motivation. Some searchers were quite straightforward when describing their frustration in current employment.

Some potential searchers mentioned search funds enabling them to leverage their skills, for example in making business decision and raising capital for acquisition. However, these remarks were made in context of comparing search fund to startups. The potential searchers seem to align with theories of Cooper, Woo, and Dunkelberg, predicting individuals with useful information for entrepreneurship from their previous employment being more likely to exploit entrepreneurial opportunities (cited in Shane and Venkataraman, 2000). However, based on the results it seems that the information is perceived to be more useful in some entrepreneurial opportunities than others (i.e. search fund or startup).

On the other hand, the lack of information and experience can also contribute to perceived weaknesses of the model. Potential searchers saw the search fund model to require more experience, and mentioned lack of knowledge and required experience preventing them of choosing the search fund path. Reflecting against Cooper, Woo, and Dunkelberg (cited in Shane and Venkataraman, 2000), the potential searchers may lack the useful information for the search fund model.

Generalizing these results leads us to following proposal:

> *Potential searchers seem to prefer search fund over startups and employment, as long as (1) expected entrepreneurial profit of search fund is higher than opportunity cost of employment or startup, (2) search fund provides more independence than employment or startup, and (3) potential searchers have information and experience that is useful especially for applying the search fund model.*

5.2 Discussion on Search Funds as an Asset Class

The second research question was “What strengths and weaknesses do potential Finnish investors see in search funds as an asset class?” The complete contracting or agency theory (Jensen & Mecklin, 1974; Spier, Hart, Van Osnabrugge, cited in Lahti 2008; Mason and Stark, 2010) led to following hypothesis on searcher preferences: “Potential investors are more attracted to invest in the acquisition stage compared to the search stage”.

Investors identified a number of strengths in the search fund model. Generally, search fund returns, valuations and opportunities were seen as attractive. The search fund model shares many workings with the standard PE model which makes evaluating proposals easy. Compared to PE, it has the additional advantage of investor making case-by-case decisions. The model was positioned as the angel investment stage of PE, where it offered active sourcing of deals, which is rarely an option for angel investors and small family offices.

The only identified weaknesses of the model were related to search capital and the inability to change the management like with PE model. The potential investors were not very fond of paying for search in advance, compared to paying for closing a deal. Number of investors pointed out that the searcher carries no downside risk, and shares only upside with investors. Only trusted searcher with exceptional access to deals was seen as potentially fundable.

From agency theory perspective, both weaknesses can be seen as investor's desire to place bonding costs to the searcher. To guarantee that the searcher (as an agent) is not going to take actions harmful for the investor (as a principal), the investor wants the searcher to invest ex-ante in building trust, and discount the post-ante risk of being removed from a management position. The desire is logical for an investor acting according to the agency theory: Moral hazard is bound to occur in the search stage, where the searcher is essentially insured by the investor by receiving a salary, despite what the outcome of the search will be.

The hypothesis of "potential investors are more attracted to invest in the acquisition stage compared to the search stage, following the logic of agency theory", seems to receive support from the identified weaknesses. In the Stanford GSB search fund model presented to the potential investors, search stage investors are receiving a 1.5x step-up for the search stage investment (A Primer on Search Funds, 2013). As the investors are preferring acquisition stage despite the step-up, it seems that they are valuating the ex-ante bonding costs to be over 50% of their returns.

Generalizing these results leads us to following proposal:

> *Potential investors are more attracted to invest in the acquisition stage compared to the search stage, following the logic of agency theory, and are willing to accept transaction costs exceeding 50% of their returns.*

5.3 Conclusions

Finnish market is likely to have targets for 4 to 8 searches per year

Based on the desk study, detailed in the literature review section, no more than 4 to 8 searches annually are required to cover the potential targets on the Finnish market. The number varies on how the market is defined, and how many potential targets need to be identified for a one acquisition.

Three market definitions were used to determine the market potential:

- Companies with €5-50M revenue provide an opportunity space of 9,101 targets. To cover this market, 5 to 18 searches are needed, leading to an estimated total acquisition volume of €50M to €180M.
- 54+ entrepreneurs employing more than 10 provide an opportunity space of 11,000 targets. To cover this market, 6 to 22 searches are needed, leading to an estimated total acquisition volume of €18M to €66M.
- Companies with €1-5M revenue provide an opportunity space of 21,000 targets. To cover this market, 10 to 42 searches are needed, leading to an estimated total acquisition volume of €30M to €126M.

Assuming the pool of potential targets fully replenishing in 10 years on average, no more than 4 to 8 search acquisitions with a volume of €25M to €36M annually can be sustained for next 10 years in the Finnish market.

Acquisition stage is very likely to have investors - search stage less likely

The empirical results of the study imply that Finnish investors would be interested in the acquisition stage. The market opportunity of retiring entrepreneurs is seen as attractive by angel investors, family offices and senior lenders. The investors are positioning search funds as angel stage PE investments, with little alternatives in <€10M segment and virtually none in <€5M. In addition, the search fund acquisition stage differs only little from traditional buyout transactions, benefiting from a familiar logic.

Annual investment of €25M to €36M is estimated to be sufficient to fully cover the market. The volume is a fraction of the €453M buyout volume in 2016 (FVCA, 2018). Reaching the potential would position the search fund market right next to startup angel investments, valued at €53M in 2016 and €26M in 2017, and crowdfunding valued at €34M in 2016 and

€56M in 2017 (Finnish Business Angels Network, 2017). In addition to current angel investors, family offices and other investors on the market, search fund acquisitions may also attract new equity investors.

However, raising search capital will be a struggle for most searchers. Investors seem to follow the logic of agency theory, and see paid search exposing them to moral hazard. Essentially, investors are happy to pay for the deals being closed, but not for the search. According to Kolarova et. al. (2016), the situation has been very much similar in other markets adapting the model: First searchers have spent most of their effort in explaining the model, instead of implementing it.

Smaller FO's and some business angels may be the first investors to go along, as they rarely have the resources and capabilities for active sourcing. For them, search stage can provide cost-effective means for actively sourcing potential targets. However, first searchers in the Finnish market likely need to adapt the self-funded variation (Dennis and Laseca, 2016), where searcher skips the fundraising for the initial search stage.

In the end, a catalyst is likely to be required to enable the search stage funding. Catalyst can provide matchmaking, facility such as tools and templates, or direct/indirect funding for search stage. Catalyst on Finnish market can be for example a private equity, family office, crowdfunding platform, accelerator, university, or a public funding institution.

Finnish market is likely to have searchers, if there are entrepreneurs

The potential searchers in this study seem to prefer search funds over startups as a career choice because of the higher expected entrepreneurial profits and lower downside risk. Compared to employment, searchers prefer the independence in search funds, but critically weigh the opportunity costs, including the financial security with current employment.

As the perceived disadvantages are essentially the same with all forms of entrepreneurship, but perceived advantages specific to the search fund model, the model should be an attractive alternative to other forms of entrepreneurship. Assuming the sample is accurately representing the potential searchers, number of potential searchers should not be a bottleneck for the model.

Few searchers pointed out that lack of knowledge and (confidence in) required skills was one of the elements holding them back. In more generalized form the study proposes that potential searchers are more likely to pursue search fund career, if they have useful

information or experience to do it. Again, this can be seen as an opportunity for a catalyst, which may provide training for the potential searchers.

Most investors preferred searchers with entrepreneurial experience. The opportunity cost holding back can be low especially with entrepreneurs who have recently given up their companies. With 324 startup CEOs raising angel investment every year, and all of them facing a (desired or undesired) liquidity event in a few years, there shouldn't be a lack of growth hungry individuals with entrepreneurial experience.

5.4 Limitations of the Study

To the author's knowledge, this study is the first one to evaluate the feasibility of the search fund model on the Finnish market. As such, it is far from complete, but hopefully provides some insight on what constraints and stakeholder expectations need to be taken in account.

The qualitative approach can be argued as most suitable for the subject matter, but comes with limitations. Generalizability of the results is limited, especially with the sample of potential searchers. Most of the potential searchers reached through Aalto alumni channels and Haaga-Helia MBA program had plenty of industry experience, but were lacking with entrepreneurial experience. In hindsight, knowing the expectations of the investors, more participants with entrepreneurial experience should have been included in the study.

One major limitation is the lack of sellers view. It can be argued that from seller's perspective the transaction should not technically differ, be the buyer a searcher, private equity or some other entity. On the other hand, selling a business can be a highly emotional experience, where the buyer's profile can matter very much. Unfortunately this perspective could not be included in the scope.

Finally, the study provides insights on stakeholder expectations, but little on how the model could actually be implemented in Finland. For this, a more inquiry on the historical development of search fund model in forerunner markets (e.g. US, UK, Spain) would have been useful.

5.5 Suggestions for Further Research

From more practical perspective, the feasibility study has provided a setting for wider action research project. The following steps would include action planning, implementation and

evaluation, and progressing through these cycles toward an operating Finnish search fund model.

From more theoretical perspective, search funds can provide a special subject matter for contracting theory. The model has a number of sequential contracts in place, with various types of asymmetric information and agency costs involved.

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Appendix A:

“Funded Search” presentation by Prof. Peter Kelly for potential searcher focus groups

funded search

Peter Kelly

Professor of Practice, High Growth Entrepreneurship, Aalto University
Visiting Professor of Business, Trinity College Dublin
Visiting Professor of Design, Pontificia Universidad Catolica de Chile

entrepreneurship by acquisition

Peter Kelly

Professor of Practice, High Growth Entrepreneurship, Aalto University
Visiting Professor of Business, Trinity College Dublin
Visiting Professor of Design, Pontificia Universidad Catolica de Chile

What is a Search Fund?

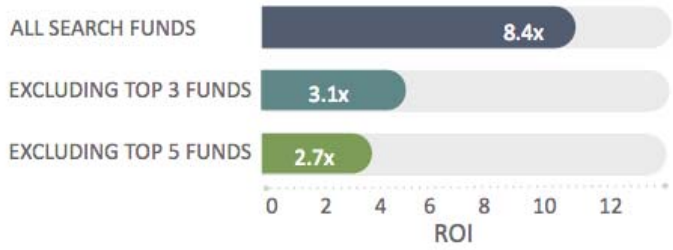
- Capital is raised to help an entrepreneur to search for and acquire a business
- Entrepreneur is usually a young MBA
- Usually have a 3-5 year outlook
- Investors and principals receive
  - Dividends
  - Capital gains (trade sale or IPO)

Advantages of a Search Fund

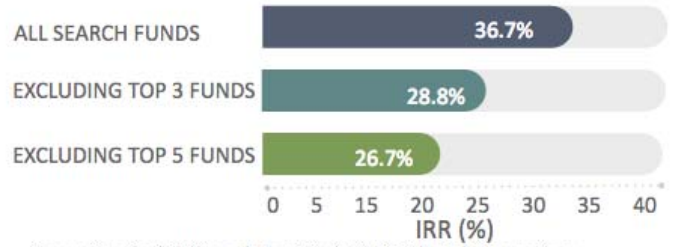
- Offers new entrepreneurs a quick path to both capital and ownership in a business
- Generates significant returns
- Investors can serve as advisors and/or board members for entrepreneur

Search Funds: Strong Performance

Search Fund Asset Class ROI (1984-2015)



Search Fund Asset Class IRR (1984-2015)



Source: Stanford CES *Search Fund Study 2016: Selected Observations*

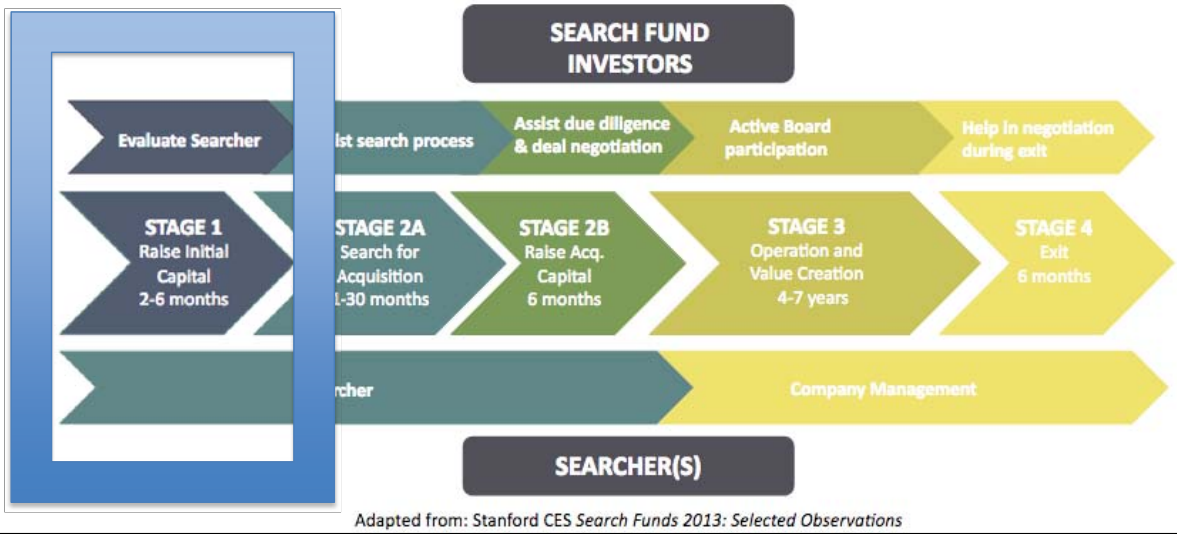
PE Fund Compare	Wgt. Avg ROI	Wgt. Avg IRR
Buyout Funds		
1980s	2.81x	16.7%
1990s	2.07x	19.3%
2000s	**1.46x**	**11%**
Overall	2.03x	15.7%
Venture Capital Funds		
1980s	2.37x	15.8%
1990s	3.76x	38.6%
2000s	**1.07x**	**0.3%**
Overall	2.46x	19.3%

Source: Kaplan, et al, 2013. *Private Equity Performance: What Do We Know?*

Raising a Search Fund

- Business plan is created
- Principals look to a wide variety of potential investors
- Each investors purchases one or several units ($20.000-$35.000)
- Entrepreneurs look for investors who can act as advisors and provide leads
- Entrepreneurs need investors who can follow on invest if a target is found

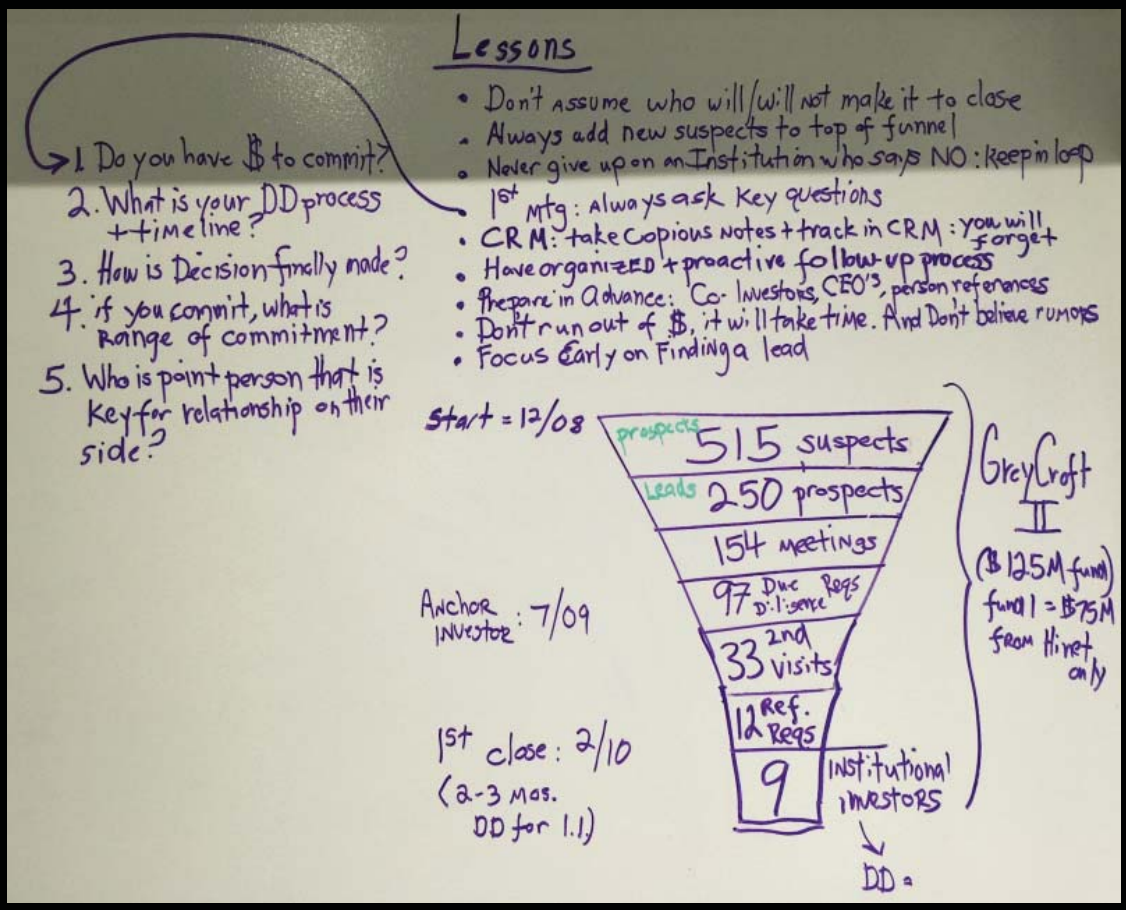
Central to Search Fund Investing is the relationship between Investors and Searchers. Over the life of a Search Fund relationship, the Investor is able to add value in each stage of the process, thereby improving outcomes for the investment overall. As a group, Investors are expected to provide a wealth of resources to aid Searchers as they transition to a Company Management role.



Adapted from: Stanford CES *Search Funds 2013: Selected Observations*

$200.000-
$350.000

$350.000-
$500.000



what type of

experience

would you like to see

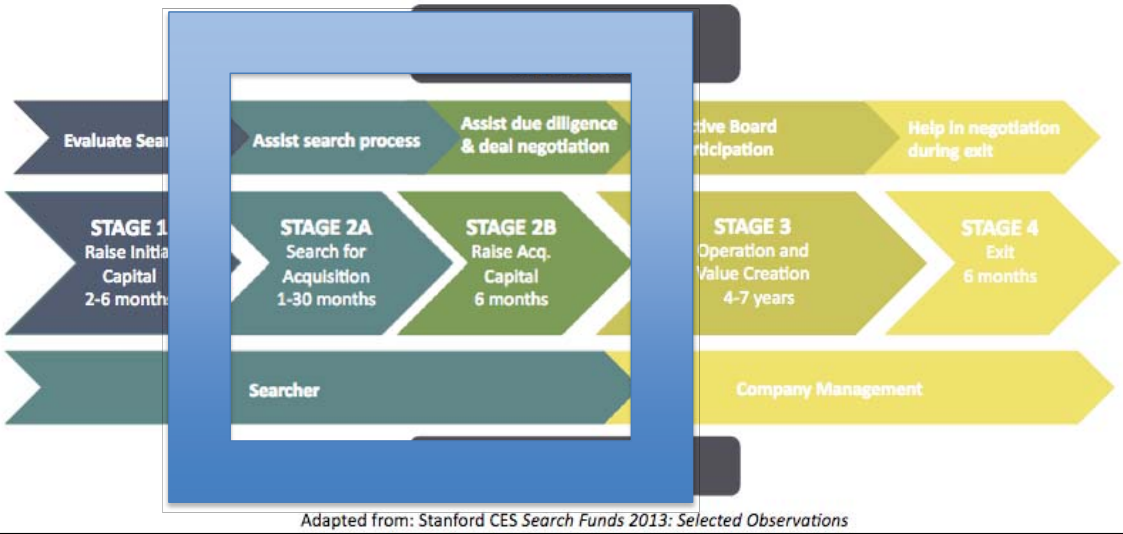
in the proponent?

is he/she

CEO

pedigree?

Central to Search Fund Investing is the relationship between Investors and Searchers. Over the life of a Search Fund relationship, the Investor is able to add value in each stage of the process, thereby improving outcomes for the investment overall. As a group, Investors are expected to provide a wealth of resources to aid Searchers as they transition to a Company Management role.



Adapted from: Stanford CES *Search Funds 2013: Selected Observations*

Searching For Targets

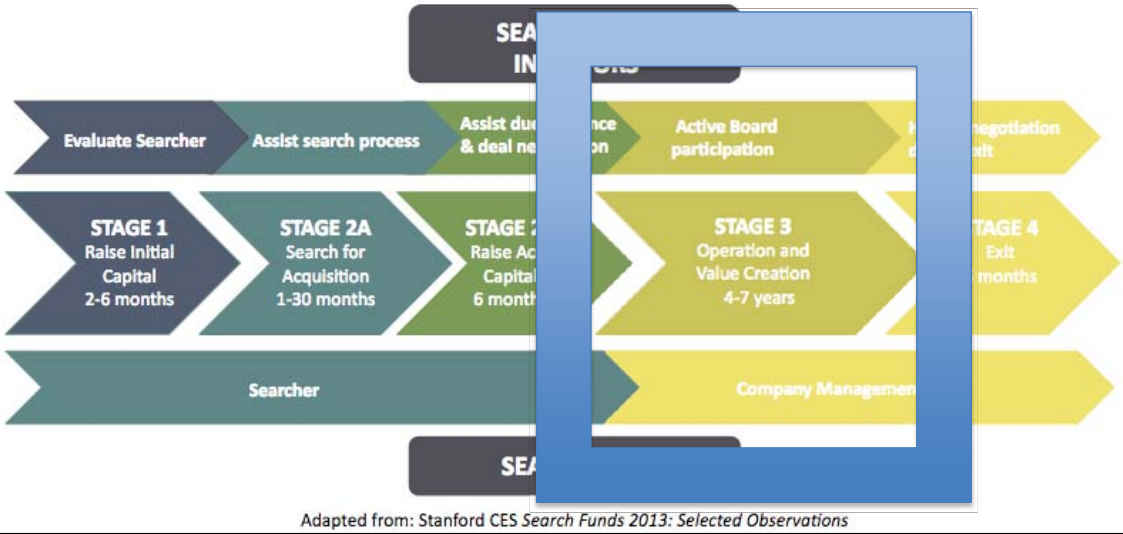
- Search by location or industry
- Location can help logistically but limit opportunities
- Target limited number of industries
- Rely on variety of sources
  - Investors
  - Brokers /Business Press
  - Banks
  - Cold calls

what kind of **investment targets** should they look for?

targets in profile

- established (ie have SALES) & profitable
- positive cash flow
- recurring revenue
- leverageable asset base
- easily understandable
- differentiated
- development potential

Central to Search Fund Investing is the relationship between Investors and Searchers. Over the life of a Search Fund relationship, the Investor is able to add value in each stage of the process, thereby improving outcomes for the investment overall. As a group, Investors are expected to provide a wealth of resources to aid Searchers as they transition to a Company Management role.



Adapted from: Stanford CES *Search Funds 2013: Selected Observations*

Funding Acquisitions

- Investors are given rights of first refusal on any acquisition
- Deals usually involve combinations of
  - Debt
  - Vendor finance
  - Equity
  - Principal is "given" an equity stake (vesting provisions, ratchets)

Acquisition Profiles

Categories	All Acquisitions Median Statistics	Top Quartile Performers Median Statistics
Purchase Price	$5.7m	$8.5m
Search Fund Investor Capital Raised	$2.2m	$2.3m
Company Revenues	$7.0m	$6.5m
Company EBITDA	$1.0m	$1.4m
EBITA Margin	17.0%	22.0%
PP/Revenue Multiple	0.9x	0.95x
PP/EBITDA Multiple	4.6x	5.6x
Company Employees	57	65

Search Fund Acquisitions

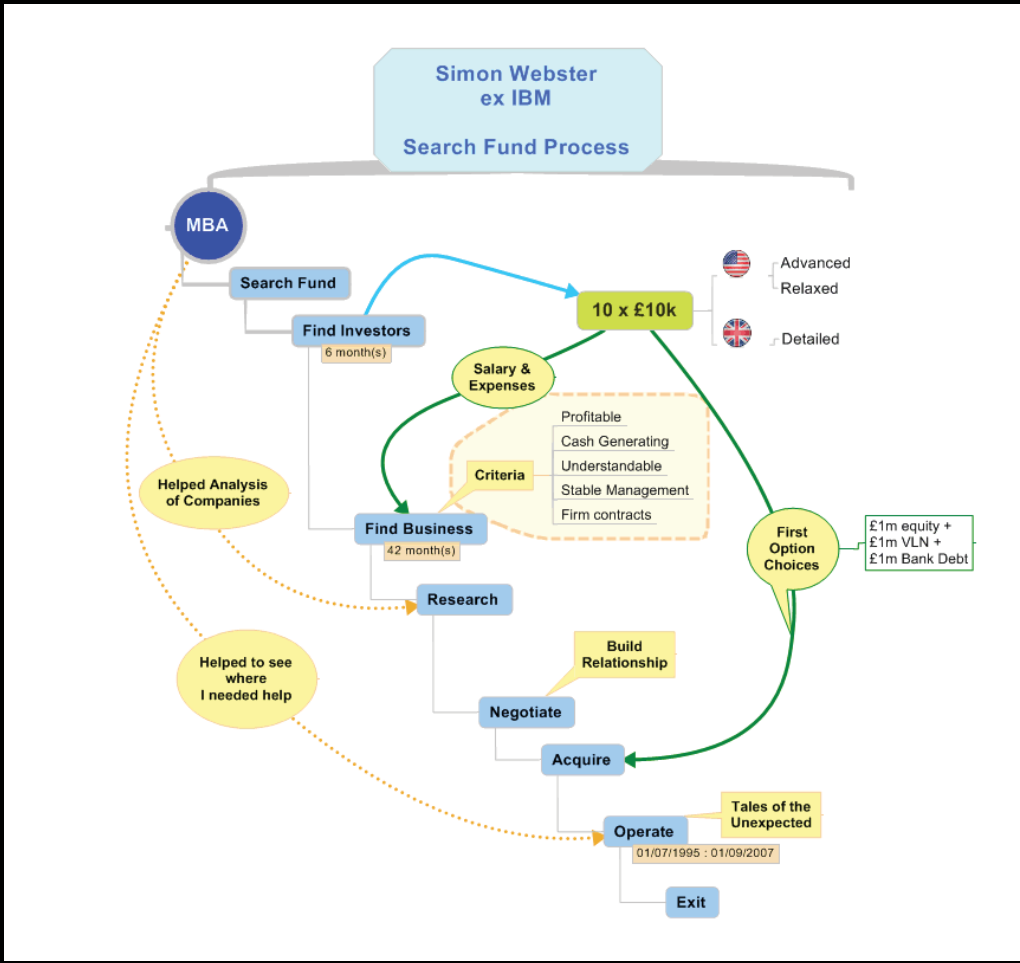
- A board of directors is formed often among fund investors
- Value is created by
  - Improving revenue growth
  - Operating efficiency
  - Expansion

Simon Webster (31)

- London Business School MBA (1992)
  - Marketing, new venture development, small business management
  - Marketing strategy for Hambros Corporate Treasury
  - Consulting project for one of UK's largest insurance companies
- National Account Manager IBM (2 years)
- Systems Engineer IBM (3 years)
- Export Sales Executive Fabricate Ltd (2 years)

Simon's Initial Plan

- Team up with a colleague to do the search
- Invest £5.000 each into search fund
- Raise £85.000 from 10 investors (3 months)
- Identify and secure a deal within 18 months



Reality Hits

- Colleague was denied visa extension
- £100.000 raised from 10 investors (6 months)
- 42 months to secure a deal (RSL)
- Looked at 100+ potential deals

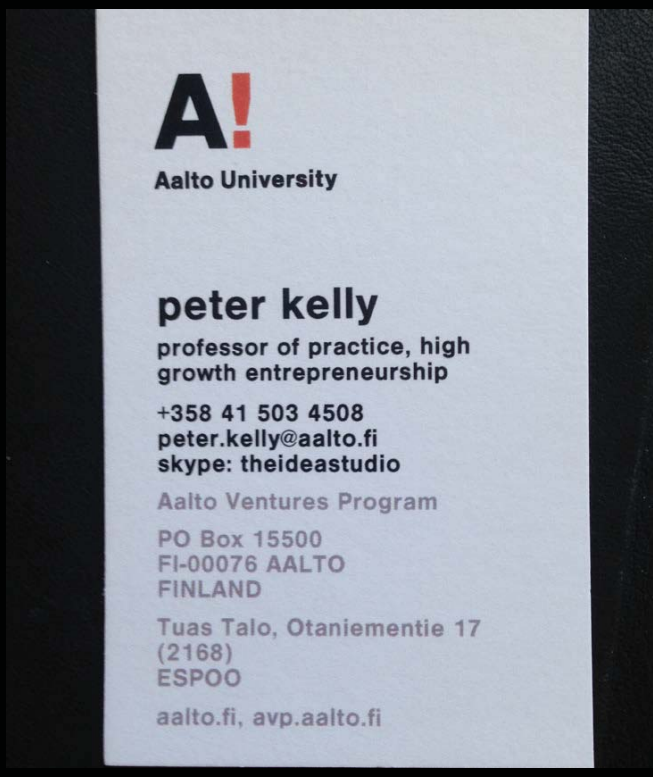
July 1995

- Bought RSL – a family owned prosthetics company for £3 million
- Investors invested £1 million
- Vendor loan £1 million & £1 million bank debt
- Simon's equity stake?

September 2007 (12 years)

- Grew business organically and through acquistion
- Sales grew from £3 million to £20 million
- EBIDTA increased from £0,4 million to £2.4 million
- Trade sale


COLEY ANDREWS | STANFORD GSB '09
SEARCH FUND MODEL:
ENTREPRENEURSHIP THROUGH
ACQUISITION
SMART + HUSTLE = Magic
DURING TRANSITION DO NOTHING BUT
LISTEN + LEARN
90% OF YOUR DAY IS REJECTION
EVERY DAY IS A BATTLE TO FIND SOMEONE WHO WILL TALK TO YOU. hello? IT TAKES CONVICTION.
BEST ADVICE
IT'S BETTER TO MOVE QUICKLY AND MAKE A MISTAKE THAN NOT MOVE AT ALL.
IT'S THE SAME HORSE GOING AROUND THE TRACK
WE'RE JUST SWITCHING OUT THE JOCKEY
BE PASSIONATE ABOUT THE
PROCESS
BUILDING TEAMS, MANAGING PEOPLE & BEING ABLE TO
TOUCH LIVES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Appendix B:

“Palveluksessa Suomi Oy - Funded search case study on the Finnish market” presentation by Mikko Järvinen for potential searcher focus groups

Palveluksessa Suomi Oy

Funded search case study on the Finnish market

Mikko Järvinen

Meet the Principal

Janne Mäki-Kahra

- 20 years in social & health care
- Sales, marketing and leadership
- MBA and trained physiotherapist

Aspa

- Foundation of patient NGO's
- 1000 housing units in Finland
- Also assisted living services

Founding Palveluksessa Suomi Oy

Quality care

PALVELUKSESSA

High profitability

Raising the Search Stage Capital




Board member competencies:

- Financial management
- HR management
- Business development
- Mergers and acquisitions
- Industry knowledge

Search capital was invested on equal terms, with commitment to provide acquisition capital on pro-rata basis

Searching and Acquiring Companies

Key evaluation criteria:

- Growth potential
- Well established
- Not too good financials
- Seller's personal reasons

-> With his good industry knowledge, Janne decided not to use a broker

Searching and Acquiring Companies

Some deal breakers:

- Unrealistic market multiples
- Unrealistic growth expectations
- Managing owners in their 50s
- Emotional ties to the company

-> Professional broker on the seller side was required to close the deals

Searching and Acquiring Companies

Acquired assisted living businesses:

- The first one acquired 6/2015
- The second one acquired 6/2016

Acquisition financed:

- 70% loan (Finnvera guarantee)
- 30% subordinated debt from the shareholders (pääomalaina)

Operating the business

First Acquired Unit

- Owner continued as the Unit manager
- Unit was providing good quality of care, but lacked in profitability
- Required optimizing in resourcing

Second Acquired Unit

- Unit manager was replaced early
- Lacked both in quality of care and profitability - old culture had to go

Exit

Options in late 2016:

- Raise capital from institutional investors and continue growth
- Continue operations with only the two acquired facilities
- Focus on home care market instead of assisted living facilities

The board decided to sell the units, and Esperi was willing to purchase.

Prices are not public, but

- Industry uses EBITDA multiples from 2.5x to 6x for valuation
- EBITDA ratios typically 15-20%
- Two units had €1.85M revenue

-> Ballpark of €0.5M to €2M

Lessons learned

- Raising additional acquisition capital turned out to be difficult. To make sure that the shareholders had the capability to provide search capital, Janne thinks he should've approached venture capitalists and institutional investors that would've had the capability for virtually unlimited follow-up investments.

- In hindsight, changing the unit manager some six months after the acquisition could've be better option also with the first one, as it was with the second one. However, this would've been a deal breaker with this specific acquisition deal.

Appendix C:

“Sample Search Fund Memorandum” research instrument for interviewing potential investors regarding the search stage investments

Sample Search Fund Memorandum

Executive Summary

SSF Oy (Sample Search Fund) is formed to identify, acquire and operate an existing Finnish private company with an initial enterprise value between €2 and €20 million and EBITDA margin of 10% or more.

The Sample Search Fund will allow the Searcher to conduct a full-time search for a period of up to 18 months. After a target company is identified and acquired, the Searcher becomes the CEO of the acquired company, and receives 10-30% ownership in the company.

The Sample Search Fund targets a 30% compound annual return on investor capital, reflecting the historical performance of search funds in US and Canada. The 258 search funds tracked by Stanford GSB have achieved an aggregate ROI of 8.4x and an IRR of 36.7%, with considerably low survival and liquidity risk.

Investment in Sample Search Fund should be viewed as a long-term investment. Investor returns will primarily come from the Searcher's ability to increase the value of the acquired company. The Sample Search Fund expects to provide investors with a liquidity event between four and six years after acquisition.

Investment structure

The Sample Search Fund is raising €150k through the sale of 10 investment units ("Units") priced at €15k each. This initial capital is intended to sustain a dedicated search for up to 18 months. For each Unit purchased, investors will receive:

- *Right of First Refusal.* Investors will have the right, but not the obligation, to participate in financing the acquisition. Depending on the size and structure of the acquisition, investors are expected to have the opportunity to invest another €100k to €200k per unit at the time of acquisition. Investors will be given the opportunity to provide 100% of the required equity capital in order to prevent dilution from outside investors.
- *Investment Step-Up*. All Units will be converted to securities in the acquired company and stepped-up by 50%, structured as a combination of equity and subordinated debt on terms pari pasu with the investor capital provided in the acquisition round of financing (i.e., for every $1.00 invested in The Sample Search Fund the investor will receive $1.50 of securities of the acquired company). This 50% step-up is meant to compensate the initial investors for the increased risk of investing in the first round of financing.

The Sample Search Fund intends to finance the acquisition through a combination of bank debt, subordinated debt, seller financing and investor capital, which may include subordinated debt, preferred stock and common stock.

The Searcher will earn an equity interest in return for identifying and acquiring the target company, and for achieving agreed upon operating results. The Searcher will have the opportunity to earn between 10-30% of the common equity, depending on the ultimate size and structure of the acquisition. A portion of this equity will be subject to meeting pre-established performance benchmarks. Neither the investors' nor the Searcher's upside is limited in any way.

Search strategy

The ultimate goal of the search strategy is to generate enough high-quality deal flow to close a transaction in not more than 18 months. The Sample Search Fund will perform an opportunistic nationwide search to generate deals that meet it's acquisition criteria. At a minimum, companies must possess the following characteristics:

Minimum attributes	**Quality dimensions**
● Niche mfg or service business ● Mgmt transition or absentee owner ● Privately-held, based in Finland ● 3 year history of profitability ● Minimum EBITDA margin of 10% ● Minimum annual EBITDA of €0.5m	● Quality of people ● Quality of industry ● Quality of cash flows ● Quality of market position ● Quality of operations ● Quality of liquidity options

The Searcher anticipates forming an Advisory Board of between three to five investors with relevant experience in sourcing opportunities and investing in private companies. The Advisory Board will be used as a sounding board for prospective investment theses and as references that may be used to establish credibility with business owners.

While a variety of sourcing alternatives exist for the opportunistic searcher, each alternative requires a different level of time and financial commitment to generate a specific volume and quality of deal flow. The Searcher believes the key to a successful opportunistic search is to balance the use of these sourcing alternatives in a focused manner while also factoring in his
professional experience and personal preferences.

The specific sources The Sample Search Fund will use to generate deal flow are as follows:

- Business brokers
- Small (investment) banks
- Direct marketing & cold calling
- Network with deal professionals and service providers
- Personal networks
- Buy-side brokers
- Advertising and public relations

Searcher options

Searcher profiles for the Sample Search Fund

Searcher A

- 30 year old
- MSc Econ. (Finance)
- 5 years of experience in investment banking and/or private equity

Searcher B

- 40 year old
- Bachelor of Hospitality Management, now studying MBA
- 20 years of industry experience specifically in catering and food industry
- 10 years of experience in management positions

Searcher C

- 40 year old
- Bachelor of Engineering, now studying MBA
- 20 years of multi-industry experience in management positions
- 10 years of entrepreneurial experience, including startup CEO

Searcher D

- 50 year old
- MBA, MSc Econ or Tech (Industrial Engineering)
- 25 years of multi-industry experience, director positions in TE500 companies
- Also some entrepreneurial experience and/or VC fund management experience

Search Stage Budget Estimate

Solo search for 18 months in EUR

Operations	
Searcher Draw	-75 000
Benefits & Insurance	-25 000
Travel	-10 000
Rent & Office Expenses	-20 000
Marketing	-10 000
Diligence and advisors	-10 000
Operations total	*-150 000*
Financing	
Equity (10 x €15k investment units)	150 000
Financing total	*150 000*
Net	
Net cash flow	*0*

Appendix D:

“Fluid Partners Financing Memorandum” research instrument for interviewing potential investors regarding the acquisition stage investments

Fluid Partners Financing Memorandum

Executive summary

The Company

Fluid Partners Oy (pseudonym) was founded in 1997 to provide vegetable oil recycling service for the food industry. The company is able to recycle the vegetable oil used in production facilities and restaurants, and return the oil for use in either food industry or as a fuel. The process effectively reduces customer's waste and material costs, and enables them to conform with various legal requirements.

The company owns one of the only centralized oil recycling facilities in the southern finland, enabling a well defendable position in its niche market. The company is well established with 2.4 million euros of revenue and EBITDA of 394 thousand euros in 2016. The company is debt-free, and has 996 thousand euros of cash & equivalent. For detailed financial history see the appendix.

Sample Search Fund has identified Fluid Partners Oy as an acquisition candidate following a detailed examination of the food industry. Sample Search Fund approached the owners, and after lengthy discussions, negotiated a detailed letter of intent.

The Transaction

The purchase price for Fluid Partners Oy is 2.5 million euros for 100% of the outstanding stock. We believe this price represents a favorable multiple of cash flows and earnings given the business' profitability, historical growth rate, and future earnings potential:

- 6.3 times 2016 EBITDA
- 1 times 2016 sales
- 1.8 times net current assets

Based on preliminary conversations with cash flow lenders, Sample Search Fund anticipates the following capital structure to finance this acquisition's purchase and closing costs:

- 1.25 million euros of senior debt
- 1 million euros of investor capital (structured as 50% subordinated debt, 50% equity)
- 250 thousand euros of seller financing

To finance this transaction Sample Search Fund will assume additional debt financing to the extent that it is available on favorable terms and up to a prudent level of cash flow coverage. Using the above capital structure, conservative assumptions for growth and profitability, and a planned sale of Fluid Partners Oy in 5 years, Sample Search Fund forecasts an equity investor IRR of 30%.

Post-Acquisition Strategy

Following completion of the acquisition, the new management plans to continue Fluid Partners Oy's profitable participation in the current vegetable oil recycling business as well as to pursue new opportunities for profitable growth.

New management plans to continue profitable growth by:

- Entering new markets (fe. Saint Petersburg region)
- Seeking follow-on acquisitions in complementary businesses
- Examining R&D opportunities in miniaturisation of oil recycling technology

New management also intends to examine a number of initiatives to reduce overall operating costs. These activities include:

- Increasing attention to, and management of, the Company's vendor network
- Focusing greater attention on operating costs related to specific customers
- Increasing the resource efficiency of the recycling processes

Following the acquisition, the Searcher will assume the role of Fluid Partners’s CEO. In addition, as a condition to closing this transaction, Fluid Partners Oy's current president has agreed to enter into an employment contract with the Company for a period of not less than six months following the closing date.

During this period, the Seller will facilitate a smooth transition of the Company's day-to-day operations and important relationships as well as continue to function as a key salesperson on a commission basis.

Global standard format

Unconsolidated, Local registry filing

	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012	31/12/2011
	EUR	EUR	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months	12 months	12 months
	Local GAAP	Local GAAP	Local GAAP	Local GAAP	Local GAAP	Local GAAP
Balance sheet						
Assets						
Fixed assets	193,000	163,000	181,000	211,643	232,000	229,000
Intangible fixed assets	0	0	0	0	0	0
Tangible fixed assets	193,000	163,000	173,000	203,463	224,000	221,000
Other fixed assets	0	0	8,000	8,180	8,000	8,000
Current assets	1,514,000	1,508,000	1,291,000	1,314,036	1,092,000	941,000
Stock	58,000	35,000	32,000	101,826	114,000	151,000
Debtors	102,000	272,000	96,000	158,625	97,000	82,000
Other current assets	1,354,000	1,201,000	1,163,000	1,053,585	881,000	708,000
∟ Cash & cash equivalent	996,000	747,000	729,000	589,686	649,000	600,000
Total assets	**1,707,000**	**1,672,000**	**1,471,000**	**1,525,679**	**1,325,000**	**1,170,000**
Liabilities & equity						
Shareholders funds	1,534,000	1,537,000	1,356,000	1,409,932	1,227,000	995,000
Capital	8,000	8,000	8,000	8,409	8,000	8,000
Other shareholders funds	1,526,000	1,529,000	1,348,000	1,401,523	1,219,000	987,000
Non-current liabilities	0	0	n.a.	n.a.	n.a.	0
Long term debt	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other non-current liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
∟ Provisions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Current liabilities	173,000	135,000	116,000	115,744	97,000	175,000
Loans	0	0	0	0	0	0
Creditors	51,000	33,000	38,000	26,827	18,000	3,000

	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012	31/12/2011
	EUR	EUR	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months	12 months	12 months
Other current liabilities	122,000	102,000	78,000	88,917	79,000	172,000
Total shareh. funds & liab.	**1,707,000**	**1,672,000**	**1,471,000**	**1,525,679**	**1,325,000**	**1,170,000**

Memo lines

Working capital	109,000	274,000	90,000	233,624	193,000	230,000
Net current assets	1,341,000	1,373,000	1,175,000	1,198,292	995,000	766,000
Enterprise value	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Number of employees	10	8	8	n.a.	6	8

Profit & loss account

Operating revenue (Turnover)	2,380,000	1,923,000	1,788,000	2,232,050	2,069,000	2,129,000
∟ Sales	2,380,000	1,923,000	1,788,000	2,231,918	2,069,000	2,130,000
Costs of goods sold	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross profit	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other operating expenses	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Operating P/L [=EBIT]	330,000	260,000	48,000	371,728	375,000	533,000
Financial P/L	7,000	7,000	22,000	14,113	10,000	5,000
∟ Financial revenue	7,000	7,000	22,000	14,118	11,000	18,000
∟ Financial expenses	n.a.	0	n.a.	5	1,000	13,000
P/L before tax	338,000	267,000	70,000	385,842	385,000	538,000
Taxation	67,000	53,000	12,000	93,359	93,000	147,000
P/L after tax	271,000	214,000	58,000	292,483	292,000	391,000
Extr. and other P/L	n.a.	76,000	n.a.	-100	n.a.	19,000
∟ Extr. and other revenue	n.a.	76,000	n.a.	n.a.	n.a.	19,000
∟ Extr. and other expenses	n.a.	n.a.	n.a.	100	n.a.	n.a.
P/L for period [=Net income]	270,000	290,000	58,000	292,382	292,000	411,000

Memo lines

Export revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Material costs	959,000	675,000	789,000	825,639	752,000	595,000
Costs of employees	574,000	535,000	463,000	509,334	428,000	472,000
Depreciation & Amortization	64,000	59,000	61,000	69,393	75,000	74,000

	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012	31/12/2011
	EUR	EUR	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months	12 months	12 months
Other operating items	451,000	392,000	427,000	455,954	438,000	n.a.
Interest paid	n.a.	n.a.	n.a.	5	1,000	13,000
Research & Development expenses	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Cash flow	334,000	349,000	119,000	361,775	367,000	485,000
Added value	n.a.	n.a.	n.a.	964,473	889,000	1,117,000
EBITDA	394,000	319,000	109,000	441,121	450,000	607,000

	31/12/2010	31/12/2009	31/12/2008	31/12/2007
	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months
Other operating items	n.a.	n.a.	n.a.	n.a.
Interest paid	4,000	5,000	4,000	7,015
Research & Development expenses	n.a.	n.a.	n.a.	n.a.
Cash flow	316,000	138,000	334,000	n.a.
Added value	767,000	474,000	660,000	n.a.
EBITDA	411,000	171,000	373,000	n.a.

Appendix E:

“Blastproof Financing Memorandum” research instrument for interviewing potential investors regarding the acquisition stage investments

Blastproof Financing Memorandum

Executive summary

The Company

Blastproof Oy is a leading provider of blast protection and special ventilation technology applied in protective constructions such as civilian shelters, hardened military facilities and the chemical and petrochemical industry.

The company was established in 1953, and became market leader in Finnish civil defence shelter equipment by 1963. Since 2010 the company has been growing globally in the industrial protection market. The company specializes in products and services related to blast protection, CBRN filtration & ventilation, and shock & vibration isolation.

The company generated annual revenue of 19.6 million euros and EBITDA of 3.394 million euros in 2016. For detailed financial history see the appendix.

Following a detailed examination, Sample Search Fund has identified Blastproof Oy as an acquisition candidate. Sample Search Fund approached the owners, and after lengthy discussions, negotiated a detailed letter of intent.

The Transaction

The purchase price for Blastproof Oy is 19.6 million euros for 100% of the outstanding stock. We believe this price represents a favorable multiple of cash flows and earnings given the business' profitability, historical growth rate, and future earnings potential:

- 5.8 times 2016 EBITDA
- 1 times 2016 sales
- 1.6 times net current assets

Based on preliminary conversations with cash flow lenders, Sample Search Fund anticipates the following capital structure to finance this acquisition's purchase and closing costs:

- 9.8 million euros of senior debt
- 7.8 million euros of investor capital (structured as 50% subordinated debt, 50% equity)
- 2 million euros of seller financing

To finance this transaction Sample Search Fund will assume additional debt financing to the extent that it is available on favorable terms and up to a prudent level of cash flow coverage. Using the above capital structure, conservative assumptions for growth and profitability, and a planned sale of Blastproof Oy in 5 years, Sample Search Fund forecasts an equity investor IRR of 30%.

Post-Acquisition Strategy

Following completion of the acquisition, the new management plans to continue Blastproof Oy's profitable participation in the current industrial protection market as well as to pursue new opportunities for profitable growth.

New management plans to continue profitable growth by:

- Seeking follow-on acquisitions in complementary businesses
- Examining R&D opportunities in company’s three key business areas

New management also intends to examine a number of initiatives to reduce overall operating costs. These activities include:

- Increasing attention to, and management of, the Company's vendor network
- Focusing greater attention on operating costs related to specific products
- Increasing the efficiency of the manufacturing process

Following the acquisition, the Searcher will assume the role of Blastproof Oy's CEO. In addition, as a condition to closing this transaction, Blastproof Oy's current president has agreed to enter into an employment contract with the Company for a period of not less than six months following the closing date.

During this period, the Seller will facilitate a smooth transition of the Company's day-to-day operations and important relationships as well as continue to function as a key salesperson on a commission basis.

Global standard format

Unconsolidated, Local registry filing

	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012	31/12/2011
	EUR	EUR	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months	12 months	12 months
	Local GAAP	Local GAAP	Local GAAP	Local GAAP	Local GAAP	Local GAAP
Balance sheet						
Assets						
Fixed assets	1,925,000	1,588,045	1,948,614	2,242,853	2,553,491	2,314,844
Intangible fixed assets	903,000	882,430	1,081,235	1,275,191	1,483,585	1,701,735
Tangible fixed assets	1,022,000	705,615	867,379	637,662	739,906	613,109
Other fixed assets	0	0	0	330,000	330,000	0
Current assets	17,812,000	10,948,538	10,143,974	11,450,796	11,645,623	15,434,308
Stock	3,630,000	3,736,401	3,870,336	3,983,897	3,865,031	4,944,929
Debtors	7,508,000	2,222,619	4,615,331	3,809,041	4,103,184	2,908,762
Other current assets	6,674,000	4,989,518	1,658,307	3,657,858	3,677,408	7,580,617
∟ Cash & cash equivalent	518,000	2,511,303	1,508,882	787,010	973,207	136,898
Total assets	**19,738,000**	**12,536,589**	**12,092,593**	**13,693,649**	**14,199,119**	**17,749,157**
Liabilities & equity						
Shareholders funds	13,800,000	10,039,396	8,843,044	8,880,039	8,056,766	11,288,498
Capital	228,000	228,150	228,150	228,150	228,150	228,150
Other shareholders funds	13,572,000	9,811,246	8,614,894	8,651,889	7,828,616	11,060,348
Non-current liabilities	648,000	577,146	263,962	476,000	950,000	1,330,000
Long term debt	453,000	577,146	263,962	476,000	650,000	910,000
Other non-current liabilities	195,000	0	0	0	300,000	420,000
∟ Provisions	195,000	0	0	0	n.a.	n.a.
Current liabilities	5,290,000	1,920,045	2,985,586	4,337,609	5,192,351	5,130,658
Loans	181,000	239,119	641,920	276,000	260,000	260,000
Creditors	1,298,000	302,858	462,904	453,252	480,626	756,095

	31/12/2010	31/12/2009	31/12/2008	31/12/2007
	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months
	Local GAAP	Local GAAP	Local GAAP	Local GAAP

Balance sheet

Assets

Fixed assets	1,512,189	1,292,812	948,857	800,762
Intangible fixed assets	802,104	884,060	452,719	407,278
Tangible fixed assets	710,085	408,752	496,138	393,484
Other fixed assets	0	0	0	0
Current assets	14,874,955	15,089,083	15,082,758	13,930,246
Stock	4,609,242	4,063,190	3,972,983	3,984,575
Debtors	2,489,696	3,536,563	2,235,135	2,442,580
Other current assets	7,776,017	7,489,330	8,874,640	7,503,091
∟ Cash & cash equivalent	255,141	140,684	1,728,906	307,585
Total assets	**16,387,145**	**16,381,901**	**16,031,619**	**14,731,013**

Liabilities & equity

Shareholders funds	11,284,752	11,377,904	10,789,118	10,306,700
Capital	228,150	228,150	228,150	228,150
Other shareholders funds	11,056,602	11,149,754	10,560,968	10,078,550
Non-current liabilities	0	n.a.	n.a.	n.a.
Long term debt	n.a.	n.a.	n.a.	n.a.
Other non-current liabilities	n.a.	n.a.	n.a.	n.a.
∟ Provisions	n.a.	n.a.	n.a.	n.a.
Current liabilities	5,102,394	5,003,994	5,242,499	4,424,311
Loans	0	0	0	0
Creditors	432,503	920,217	389,909	473,758

	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012	31/12/2011
	EUR	EUR	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months	12 months	12 months
Other current liabilities	3,811,000	1,378,068	1,880,762	3,608,357	4,451,725	4,114,563
Total shareh. funds & liab.	**19,738,000**	**12,536,589**	**12,092,593**	**13,693,649**	**14,199,119**	**17,749,157**

Memo lines

Working capital	9,840,000	5,656,162	8,022,763	7,339,686	7,487,589	7,097,596
Net current assets	12,522,000	9,028,493	7,158,388	7,113,187	6,453,272	10,303,650
Enterprise value	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Number of employees	77	77	81	84	90	90

Profit & loss account

Operating revenue (Turnover)	19,565,000	16,324,163	19,795,568	15,571,209	20,788,583	17,007,471
∟ Sales	19,429,000	15,879,664	19,390,711	15,525,871	21,067,535	16,538,843
Costs of goods sold	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross profit	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other operating expenses	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Operating P/L [=EBIT]	2,813,000	2,273,477	3,293,252	1,191,290	2,072,121	-904,777
Financial P/L	41,000	-27,077	-29,056	-32,930	-4,831,345	51,495
∟ Financial revenue	100,000	4,785	9,673	11,147	8,243	147,530
∟ Financial expenses	59,000	31,862	38,729	44,077	4,839,588	96,035
P/L before tax	2,853,000	2,246,401	3,264,196	1,158,360	-2,759,223	-853,281
Taxation	577,000	450,649	657,081	275,088	475,481	2,972
P/L after tax	2,276,000	1,795,752	2,607,115	883,272	-3,234,704	-856,253
Extr. and other P/L	n.a.	n.a.	n.a.	n.a.	n.a.	860,000
∟ Extr. and other revenue	n.a.	n.a.	n.a.	n.a.	n.a.	860,000
∟ Extr. and other expenses	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
P/L for period [=Net income]	2,277,000	1,795,752	2,607,115	883,272	-3,234,704	3,746

Memo lines

Export revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Material costs	3,957,000	3,661,248	5,531,140	3,852,033	7,112,407	7,027,913
Costs of employees	5,236,000	4,896,137	5,518,784	5,254,862	5,515,537	5,223,214
Depreciation & Amortization	581,000	613,835	411,849	432,222	462,452	422,865

	31/12/2010	31/12/2009	31/12/2008	31/12/2007
	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months
Other current liabilities	4,669,891	4,083,777	4,852,590	3,950,553
Total shareh. funds & liab.	**16,387,145**	**16,381,901**	**16,031,619**	**14,731,013**

Memo lines

Working capital	6,666,435	6,679,536	5,818,209	5,953,397
Net current assets	9,772,561	10,085,089	9,840,259	9,505,935
Enterprise value	n.a.	n.a.	n.a.	n.a.
Number of employees	70	68	63	58

Profit & loss account

Operating revenue (Turnover)	11,821,800	13,619,104	18,378,234	16,360,850
∟ Sales	12,003,900	13,330,609	17,937,540	16,412,290
Costs of goods sold	n.a.	n.a.	n.a.	n.a.
Gross profit	n.a.	n.a.	n.a.	n.a.
Other operating expenses	n.a.	n.a.	n.a.	n.a.
Operating P/L [=EBIT]	-851,685	188,871	3,016,669	1,582,311
Financial P/L	308,532	311,061	442,103	302,367
∟ Financial revenue	328,388	314,827	465,567	315,498
∟ Financial expenses	19,856	3,766	23,464	13,131
P/L before tax	-543,153	499,932	3,458,771	1,884,678
Taxation	n.a.	211,146	176,353	75,893
P/L after tax	-543,153	288,786	3,282,418	1,808,785
Extr. and other P/L	450,000	300,000	-2,800,000	-1,600,000
∟ Extr. and other revenue	450,000	300,000	n.a.	n.a.
∟ Extr. and other expenses	n.a.	n.a.	2,800,000	1,600,000
P/L for period [=Net income]	-93,153	588,786	482,418	208,785

Memo lines

Export revenue	n.a.	n.a.	n.a.	n.a.
Material costs	3,876,282	4,651,876	5,751,246	6,333,782
Costs of employees	4,194,042	4,161,695	4,465,460	4,121,433
Depreciation & Amortization	342,303	281,757	268,633	249,502

	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012	31/12/2011
	EUR	EUR	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months	12 months	12 months
Other operating items	6,979,000	4,879,462	5,040,540	4,840,904	5,626,062	n.a.
Interest paid	59,000	31,862	38,729	44,077	109,588	96,035
Research & Development expenses	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Cash flow	2,858,000	2,409,587	3,018,964	1,315,494	-2,772,252	426,611
Added value	8,730,000	7,788,235	9,233,558	6,889,521	3,328,354	5,748,832
EBITDA	3,394,000	2,887,312	3,705,101	1,623,512	2,534,573	-481,912

	31/12/2010	31/12/2009	31/12/2008	31/12/2007
	EUR	EUR	EUR	EUR
	12 months	12 months	12 months	12 months
Other operating items	n.a.	n.a.	n.a.	n.a.
Interest paid	19,856	3,766	23,464	13,131
Research & Development expenses	n.a.	n.a.	n.a.	n.a.
Cash flow	249,150	870,543	751,051	458,287
Added value	n.a.	5,247,150	5,416,328	4,668,744
EBITDA	-509,382	470,628	3,285,302	1,831,813